2006 SIXTH CIRCUIT JUDICIAL CONFERENCE

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"Employee and Retirement Benefit Plans in Bankruptcy: Can they survive?"

EMPLOYEE AND RETIREMENT BENEFIT PLANS IN BANKRUPTCY: CAN THEY SURVIVE?

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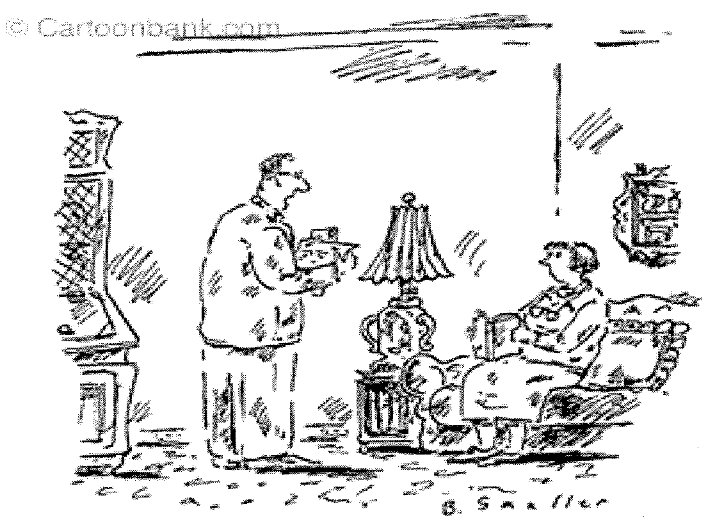

"My pension has been renegotiated, and in lieu of a monthly check I'll receive a crateful of seasonal fruit."

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HYPOTHETICAL

Toledo Industrial, Inc. ("Industrial"), a public company, manufactures industrial machinery. Industrial has 1,500 bargaining unit employees represented by the Allied Production Workers Union ("Union"), and 250 salaried employees, at its plants in Ohio. The current collective bargaining agreement ("CBA") was signed in 2003, and will expire in September 2006.

A decade ago, Industrial established a wholly-owned subsidiary, Toledo Industrial de Mexico, S.A. ("Industrial Mexico"), to take advantage of Mexico's lower wages and hospitable business climate. Industrial Mexico is profitable, and has accounted for an increasing portion of Industrial's production, while Industrial's Ohio plants have consistently lost money. Industrial keeps the Ohio plants open: (a) to provide a service center near its customer base; and (b) because it hopes to land some new and profitable supply contracts.

As a result of collective bargaining, Industrial established the Toledo Industrial Hourly Employees Pension Plan ("Hourly Plan"), a single-employer defined benefit plan. All bargaining unit employees participate in the Hourly Plan, along with several thousand retirees and former employees with vested benefits. Under the CBA, Industrial is required to "maintain the Hourly Plan for the term of this Agreement" and contribute to the Plan "the amounts required by federal law." Industrial also maintains the Toledo Industrial Salaried Employees' Pension Plan ("Salaried Plan"), also a single-employer defined benefit plan. All salaried employees participate in the Salaried Plan, along with 1,000 or so retirees and deferred vesteds. Industrial also maintains a 401(k) plan for salaried employees, with an employer matching contribution.

Industrial maintains a comprehensive health care plan, on a self-insured basis, for active bargaining unit employees and hourly pensioners. This coverage has been provided for in each CBA (in the case of pensioners, "for the lifetime of the pensioner and/or surviving spouse") since 1970. As a matter of policy, Industrial has provided the same health care coverage to salaried employees and pensioners.

Industrial's plant and equipment are pledged to Advantage Financial Corp. ("AFC") for a $160 million long-term loan, and its accounts receivable and inventory are pledged to Commercial Credit, Inc. ("CCI") for a $50 million revolving credit line. Industrial also has $250 million in unsecured bond debt.

For 2006, on a consolidated basis and based on $810 million in North American revenues, Industrial projected $40 million in gross earnings (EBITDA). It projected the following draws on its cash, among others:

-$10 million to service secured credit facilities, and $15 million to service unsecured debt;

-$20 million for tooling and capital expenditures to support current supply agreements;

-$8 million for price-downs to customers under the supply agreements;

-$8 million for pension contributions to the Hourly Plan, and $2 million to the Salaried Plan; and,
$10 million for retiree health care.

In addition, Industrial's SG&A (sales, general and administrative) expenses amount to $47.5 million annually.

2005 was a very bad year, due to rising energy costs and slack demand. Industrial considered reducing costs by shifting all production to Mexico, but that would have diminished its chances of landing new supply contracts in the Midwest. Industrial would also have owed supplemental unemployment benefits and health benefits for six months to terminated hourly employees under the CBA, and six months' severance pay to terminated salaried employees.

Industrial Mexico's plant and equipment are largely unencumbered. AFC has been willing to lend Industrial additional funds for capital expenditures to attract more lucrative contracts. But AFC would require that Industrial pledge its stock in Industrial Mexico as collateral, and that Industrial Mexico pledge its plant and equipment.

In the interim, Industrial sought to take steps in order to rationalize its operations and free up cash by:
-freezing salaried 401(k) matching contributions;
-suspending scheduled pay increases for salaried employees and imposing increased cost-sharing for salaried retirees' health care;
-seeking to re-open the CBA to negotiate similar concessions by hourly employees and hourly retirees; and,
-seeking to renegotiate customer supply agreements.

In need of breathing room to develop a comprehensive restructuring plan, in April 2006 Industrial filed a chapter 11 bankruptcy petition. Industrial's "first-day" motions (which the bankruptcy court granted), provided for continuation of all employee benefit programs at existing levels. Shortly thereafter, Industrial filed a motion seeking to implement a Key Employee Compensation Program, paying $ 3 million per year to executives and $3 million to other "key" employees.

Industrial has now approached the Union for wage and benefit concessions, seeking, among other things, to:
-reduce and then freeze hourly wages for three years;
-freeze the union pension plan, ceasing any further benefit accruals, while reserving the future right to pursue plan termination;
-terminate the self-insured health care plan for retirees, and establish a Voluntary Employees' Beneficiary Association (VEBA), with an annual cash contribution based on 5% of Industrial's "free cash flow" (EBITDA less Capital Expenditures and Interest Expenses).

Industrial would like to pursue a stand-alone reorganization, but requires improved financial results in order to secure exit financing. Industrial's financial advisors have suggested an EBITDA target of 10% of revenues, or $80 million, as an aspirational objective.

Industrial has been approached by Flint Investments, Inc. ("Investments"), which buys undervalued companies, cleans up their balance sheets, and then sells shares to the public. Investments owns 100% of California Chemical Products Corp., and minority interests in other acquisitions that it has already taken public. Investments is interested in acquiring Industrial's operations, and is indifferent to the form of the transaction, i .e., a stock purchase or an asset purchase, as long as the price is right. Investments has reviewed Industrial's latest audited financial statements, and noted that Industrial has unfunded pension benefit obligations of $57,000,000, and an "OPEB" liability of $62,000,000. Investments believes that to make Industrial profitable in the long run, it will need to implement head-count reductions and work-rule changes, for which it will need Union support.

A SUMMARY DESCRIPTION OF CORPORATE REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

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"Bankruptcy is a legal proceeding in which you put your money in your pants pocket and give your coat to your creditors."

(Joey Adams 1911-1999)

I. OVERVIEW

A. The Bankruptcy Code and Bankruptcy Rules.

1. The Bankruptcy Code is contained at 11 U.S.C. §§101 *et seq.* (cited herein as "§___").

2. Supplemental issues and matters of procedure are treated in the Federal Rules of Bankruptcy Procedure (cited herein as "FRBP __").

B. Structure and Organization.

1. Bankruptcy cases are either liquidations or reorganizations. In a liquidation case the assets of the estate are liquidated and the proceeds distributed to creditors. In a reorganization case, the debtor generally retains its assets and makes distributions to creditors pursuant to a "plan" approved by the Court.

2. A chapter 7 case is the generic liquidation case, which may be used by individuals or entities.

3. A chapter 11 case is the generic reorganization case, which is used by entities and sometimes by individuals.

4. A chapter 13 case is a simplified reorganization case, intended for individuals and certain sole proprietorships. A chapter 12 case is a specialized reorganization case for family farmers.

5. Bankruptcy Code provisions in the 100's, 300's and 500's are applicable to all types of bankruptcy cases. Provisions in the 700's are limited to chapter 7 cases. Provisions in the 1100's are limited applicable only in chapter 11 cases.

6. The remainder of this outline deals almost exclusively with chapter 11 reorganization cases.

II. COMMENCEMENT OF A CASE

A. Location of Filing.

1. A case may be filed where either the principal place of business or the principal assets of a corporation have been located for the majority of the preceding 180 days. 28 U.S.C. §1408(1). A corporation's state of incorporation may also be accepted as a location for filing.

2. A case may also be filed where there is a pending case concerning a corporation's affiliate. 28 U.S.C. §1408(2). "Affiliate" includes for bankruptcy purposes, among other things, (i) a parent that controls at least 20% of the voting securities of the corporation, and (ii) a subsidiary at least 20% of whose voting securities are controlled by the corporation. §101(2).

B. A Voluntary Case.

1. A voluntary chapter 11 case is commenced by filing a pleading known as a petition. §301(a). The corporation need not allege that it is insolvent or unable to pay its debts as they mature. Instead, the corporation must merely determine that reorganization is desirable in order to respond to its financial situation, although even that need not be specifically alleged in the petition.

2. The filing of a voluntary petition automatically produces the effects described in Section II below. §301(b).

C. An Involuntary Case.

1. An involuntary case is commenced against a corporation by the filing of a petition by three or more unsecured creditors whose claims aggregate at least $12,300. §303(b)(1). That amount is subject to future adjustment based on a "cost of living" formula. The involuntary petition must allege one of two grounds: either (i) that the corporation is generally not paying its debts as they become due, or (ii) that a receiver or trustee was appointed for the corporation within the previous 120 days. §303(h).

2. The corporation may contest an involuntary petition and, unless the Court orders otherwise, may continue to operate its business pending a decision on the petition. §303(f). If the creditors prove the allegations of the involuntary petition, the Court enters an "order for relief" and the case then proceeds in a manner identical to a voluntary case. §303(h).

3. The petitioning creditors may choose to file their involuntary petition either for reorganization under chapter 11 or for liquidation of the corporation under chapter 7. However, the corporation has the absolute right to convert a chapter 7 liquidation case to a reorganization case under chapter 11. §706(a).

D. Financial Schedules.

1. Upon the commencement of the case, the corporation (now known as the debtor or debtor-in-possession) must file itemized schedules of assets and liabilities (including a list of creditors and shareholders) and a Statement of Financial Affairs, detailing certain aspects of its pre-bankruptcy financial affairs. §521(a); FRBP 1007(b)(1).

2. The debtor must also file information describing its various outstanding contractual relationships. FRBP 1007(b)(1).

III. EFFECTS OF THE COMMENCEMENT OF A CASE

A. The Automatic Stay.

1. The filing of a chapter 11 petition automatically brings into effect a statutory injunction against the commencement or continuation of virtually all legal proceedings and other creditor actions against the debtor. §362(a).

2. Limited exceptions are provided, such as for governmental actions to enforce police or regulatory powers. §362(b).

B. Status of Liabilities.

1. The corporation's unsecured debts on the date of the petition are "frozen." Interest ceases to accrue and payments need not be made. §502(b). The creditors' claims are initially established either through a schedule of claims that the debtor files with the Court or through a "Proof of Claim" filed by the creditor. FRBP 3003(b)(1), (c)(1).

2. Obligations incurred after the filing of the petition are "expenses of administration" and are paid either in the ordinary course of the debtor's business or under the plan of reorganization with priority over pre-petition claims. §503(b); §1129(a)(9)(A).

3. Designated categories of employee claims and tax claims and other limited claim categories are also provided with a statutory right to priority in payment over other pre-petition liabilities. §507.

C. Practical Effects.

1. The filing of a chapter 11 case will disrupt the normal flow of business relationships.

2. Vendors often hesitate to continue sales under their usual terms and may require payment in advance or on delivery; banks may assert claims over the debtor's deposits; and distributors, dealers, joint venturers and customers may require, at the very least, solid encouragement that the business will continue.

3. Competitors often use the debtor's bankruptcy filing as an opportunity to seek to lure away the best of the debtor's employees, using the natural concern about the future with a distressed company.

IV. INITIAL CONSIDERATIONS

A. "First Day Orders."

1. A voluntary petition is often accompanied by motions requesting immediate relief on a number of issues.

2. The subjects treated regularly include maintenance of financial systems, preservation of utility service, payment of employee expenses, retention of debtor professionals and the like.

3. Secured credit is also addressed at the initial hearings, as described further below.

4. Court procedures for the handling of such motions vary. Some requests may be approved almost immediately. Other motions may be approved on an interim basis, subject to later objection, or set for hearing prior to being granted.

B. Appointment of a Creditors' Committee.

1. Shortly after the filing, the United States Trustee ("UST") will appoint a committee of creditors ordinarily consisting of the seven largest unsecured creditors who are willing to serve. §§1102(a)(1), (b)(1).

   a. In large cases there may be intense competition for participation on the creditors committee.

   b. In smaller cases, it is often difficult to find creditors willing to serve.

2. The UST may also appoint additional committees of creditors or of equity security holders if necessary to assure adequate representation of the creditors or of equity security holders. §§1102(a)(1), (2).

3. The functions of the committee (or committees) include (i) investigation of the debtor, the operation of its business, the desirability of continuing that business, and other matters relevant to the case; (ii) participation in the formulation of a plan of reorganization, and (iii) consideration of whether to request the appointment of a trustee or examiner. §1103(c).

4. With the approval of the Court, a committee may employ attorneys, accountants and other professionals at the expense of the debtor's estate, to assist the committee in the performance of its duties. §1103(a).

C. First Meeting of Creditors.

1. Shortly after the filing of the petition, a meeting of creditors known at the "341 Meeting" will be scheduled by the UST. §341(a).

2. At the 341 Meeting, officers of the debtor will be examined by the UST under oath about the debtor and its financial affairs. Creditors are also permitted to ask questions about matters pertinent to the bankruptcy case. §341(d).

D. Debtor in Possession vs. Trustee.

1. After commencement of a chapter 11 case, the debtor ordinarily continues to operate its business and is known as a "debtor in possession." §1107(a).

2. At any time thereafter, on request of any interested party, the Court may order the appointment of a trustee. §1104(a).

   a. Reasons for such an appointment include fraud, dishonesty, incompetence, or gross mismanagement by management or if such appointment is otherwise in the interest of creditors, any equity security holders, and other interests of the estate. §§1104(a)(1), (2).

   b. If a trustee is appointed, he will have the authority to operate and investigate the debtor's business and to formulate and propose a plan of reorganization. §1106.

3. If the Court does not order the appointment of a trustee, then if requested by a party in interest and after notice and a hearing, the Court will appoint an "examiner" to conduct appropriate investigations of the debtor and its current or former management if (i) the appointment is in the interests of creditors, equity security holders and other interests of the estate, or (ii) the debtor's unsecured debts exceed $5 million. §1104(c).

E. Conversion or Dismissal of the Case.

1. At any time, an interested party may ask the Court to dismiss the case or convert it to a liquidation case under chapter 7. §1112(b).

2. The Court may convert or dismiss a chapter 11 case (whichever is in the best interests of creditors and the estate) for cause, including (i) continuing losses and the absence of a reasonable likelihood of rehabilitation, (ii) inability to effectuate a plan, or (iii) unreasonable delay by the debtor that is prejudicial to creditors. §1112(b).

F. Consolidation.

1. If a corporation and its subsidiaries, or a series of brother-sister corporations, file petitions under chapter 11, the question of whether to consolidate the cases may arise.

2. Cases involving affiliates are frequently consolidated for procedural purposes only, to simplify the process for filings and docket maintenance.

3. The Court also has the power, under appropriate circumstances, to legally combine the assets and liabilities of two or more corporations. This is an equitable remedy known as "substantive consolidation."

   a. Substantive consolidation is used when the assets and liabilities of a group of companies are hopelessly entangled or when the corporate structures have been used in a manner that took advantage of creditors.

   b. The creditors of corporations with the worst prospects for reorganization will be inclined to favor consolidation, while the creditors of the healthier corporations will tend to oppose it.

IV. OPERATION OF THE DEBTOR'S BUSINESS

A. Operation in the Ordinary Course of Business.

1. So long as a trustee has not been appointed, and unless the Court orders otherwise, the debtor will have general authority to use, sell or lease its property in the ordinary course of business. §363(c)(1).

2. The debtor may use, sell or lease its property other than in the ordinary course of business only with specific court authorization. §363(b)(1).

B. The Use of Property Subject to a Security Interest.

1. Secured creditors may seek to place important limitations on the ability of the debtor to operate its business (and thus to reorganize). Early in the reorganization, the debtor can expect disputes, and perhaps litigation, with secured creditors concerning the possession and use of collateral.

2. The automatic stay prohibits a secured creditor from recovering its collateral. The secured creditor is entitled to relief from the stay (i.e., to the

return of its collateral) only if (i) the secured creditor's interest in the collateral is not given "adequate protection", or (ii) the debtor has no equity in the collateral and the collateral is not necessary for an effective reorganization. §§362(d)(1), (d)(2). Unless the stay is modified or removed, the debtor may ordinarily use, lease or sell the collateral.

3. The Code does not define "adequate protection." It does list some examples such as periodic payments or additional liens. §361. However, a debtor's proposed response in any specific situation will be dependent on the particular facts of the case.

4. Cash and assets readily convertible into cash are known as "cash collateral." Due to their volatility, the debtor may not use cash collateral without advance approval by the Bankruptcy Court. §363(c)(2).

    a. Terms for use of cash collateral are often treated in "first day" orders immediately after filing.

    b. Such orders may include budgets, replacement liens and additional limitations designed to protect the creditor's lien in the assets.

C. Asset Sales.

1. The general authorization to use or sell assets has been expanded to include sales of substantial segments of the debtor's business, or even the entire debtor business.

    a. Although assets sales may also be accomplished through a plan of reorganization, parties often prefer the so-called "363 sale" because it is faster and less complicated.

    b. In sales of substantially all of the debtor's assets, courts ordinarily require some showing of necessity in order to utilize a transaction that does not include the process, protections and voting of a plan of reorganization.

2. Debtors also employ marketing or other steps to demonstrate that they have obtained the best available value for the assets being sold so that the transaction is in the "best interests of the estate."

    a. Ordinarily, the price and other terms of the purchase will be the exclusive determining factor.

    b. Sometimes, however, the presence or absence of negotiated arrangements between an offeror and the debtor's collective bargaining representative can provide indirect benefit that can influence the bid selected.

D. Obtaining Credit.

1. Unless the Court orders otherwise, the debtor may obtain unsecured credit and incur unsecured debt in the ordinary course of business. §§364(a), (b). Such indebtedness will be an expense of administration with priority over pre-petition claims. The likelihood of obtaining this type of credit (except on trade accounts) is generally remote.

2. If the debtor is unable to obtain credit as an expense of administration, the Court, after notice and hearing, may authorize borrowings (i) with a super-priority of payment over all other expenses of administration, (ii) secured by a lien on property not otherwise encumbered, or (iii) secured by a lien on property junior to existing liens. §364(c).

3. If the debtor is unable to obtain credit even with super-priority or a lien as described above, the Court, may authorize the debtor to borrow secured by a lien on property equal or superior to any existing lien, provided that the interest of the existing lienholder is "adequately protected." §364(d).

V. SPECIAL "AVOIDING POWERS" OF THE DEBTOR IN POSSESSION

A. General.

1. The debtor (or the trustee, if a trustee has been appointed) has the power to set aside and recover a variety of pre-bankruptcy transfers of the debtor's property, including certain statutory liens, setoffs and fraudulent transfers.

2. Frequently, the most significant of these "avoiding powers" is the right to recover preferential payments.

B. Recovery of Preference Payments.

1. A preference is a transfer of the debtor's property (e.g., a cash payment or the granting of a security interest) made to or for the benefit of a creditor within 90 days of bankruptcy if (i) the transfer was on account of a pre-existing debt, (ii) the debtor was insolvent at the time, and (iii) the transfer enabled the creditor to receive more than its pro rata share. §547(b).

    a. A corporation is insolvent if the sum of its debts is greater than all of its property, at a fair valuation. §101(32).

    b. The debtor is presumed to have been insolvent during the 90 days prior to bankruptcy. §547(f). However, if some evidence of solvency is introduced, the debtor has the ultimate burden of proving insolvency. §547(g).

2. The preference period is extended from 90 days to one year for transfers to "insiders." §547(b)(4)(B). "Insider" is defined broadly to include, among

others, officers, directors, persons in control of the debtor, affiliates and insiders of affiliates. §101(31).

3. If a transfer meets the affirmative requirements of the preference section, the transferee can escape liability if it can establish certain defense. Described below are some of the most frequently used defenses.

    a. Transfers considered to be contemporaneous exchanges for new value §547(c)(1);

    b. If a debt incurred in the ordinary course of business is paid in the ordinary course of the parties' business or paid according to ordinary business terms §547(c)(2); or

    c. Transfers after which the creditor provides "subsequent new value to the debtor which remains outstanding. §547(c)(4)

C. Other Avoiding Powers.

1. Debtors may also "avoid" a variety of other types of transactions. These include (i) unperfected liens or transfers §544(a); (ii) certain statutory liens §545; (iii) fraudulent transfers §§544, 548; (iv) various post-petition payments §549; and (v) certain pre-petition offsets. §553.

2. In general, any actions to exercise avoiding powers must be brought within two years of the filing of the petition. §546(a).

D. Executory Contracts and Leases.

1. Subject to the Court's approval, the debtor may, in the exercise of reasonable business judgment, assume or reject any "executory contract" or unexpired lease. §365(a).

    a. The Bankruptcy Code does not define "executory contract."

    b. Although the judicial definitions have not always been clear or consistent, it can be said as a general matter that an executory contract is a contract for which material performance remains for both parties.

2. Contractual provisions that would prohibit assumption by the debtor are generally unenforceable. §365(e)(1). If the contract or lease is in default, it may not be assumed unless the debtor in possession first cures the default, provides for the payment of damages and provides adequate assurance of future performance. §365(b)(1).

3. If the debtor assumes a contract or lease, it must perform the contract or lease in accordance with its terms, and damages resulting from any breach will be an expense of administration.

4. If a contract or lease is assumed, it may be assigned to a third party if the debtor provides adequate assurance of future performance by the assignee. §365(f)(2).

5. The rejection of a contract or lease, on the other hand, is deemed to be a breach immediately prior to the bankruptcy, and damages resulting from that breach will be allowed as a general unsecured claim on parity with other pre-petition claims. §365(g)(1).

6. During the period between the petition date and the date when the debtor implements its decision to assume or reject a lease of commercial property, the debtor will be obligated to perform many of its obligations under the lease.

E. Special Treatment Afforded Certain Executory Contracts.

1. Some categories of executory contracts have been singled out for special protections by Congress.

2. For example, the property rights of a real estate purchaser or lessee are protected from some consequences of rejection by the seller or lessor. §§365(h); (i). Licensees of intellectual property receive similar protections. §365(n).

3. Shopping center landlords receive special types of "adequate assurance of future performance. §365(b)(3).

F. Treatment of Certain Employee-Related Agreements.

1. In response to application of executory contract principles to collective bargaining agreements and retiree health care arrangements, Congress adopted specific provisions to deal with a chapter 11 debtor's efforts to avoid these types of obligations.

2. A chapter 11 debtor may only reject or modify a collective bargaining agreement after compliance with a specific set of requirements.

   a. The debtor must first make a post-petition proposal embodying those changes necessary to permit the debtor's reorganization. §1113(b)(1).

   b. The debtor must bargain in good faith with the collective bargaining representative regarding such proposed modifications. §1113(b)(2).

   c. The court may only approve rejection only if it determines that the bargaining representative has refused to accept the proposed modification without good cause and that the balance of equities favors rejection. §1113(c).

d. Interim changes may only be approved by the court only to the extent necessary to continuation of the debtor's business and to avoid irreparable damage to the estate. §1113(e).

3. Somewhat similar limitations are imposed on efforts by the debtor to modify or terminate "retiree benefits," - - principally medical and other insurance for retirees. §1114.

a. The collective bargaining representative may serve as the bargaining representative for its retirees. §1114(c).

b. In addition, provision is made for the appointment of a committee of retiree creditors to engage in the bargaining process over proposed modifications. §§1114(c), (d).

VI. THE PLAN OF REORGANIZATION

A. Filing of a Plan.

1. The debtor has the exclusive right to file a plan of reorganization during the first 120 days of the case. §1121(b). The Court may reduce or extend this exclusive period for cause. §1121(d).

2. After the period has run, if a plan has not been filed, any interested party may file and seek confirmation of a plan. §1121(c).

B. The Plan.

1. The plan of reorganization is essentially a contract between the debtor and its creditors. The plan divides the creditors into classes of substantially similar claims and sets forth how they are to be treated.

a. When the shareholders' interests are to be affected, the plan will deal with their interests as well.

b. There are no requirements as to the form of payment under the plan. Claims may be extinguished, compromised or extended, or may be exchanged for debt or equity securities of the reorganized company or combinations of the foregoing.

2. The plan is submitted to creditors and shareholders for approval. The solicitation of acceptances must be accompanied by a disclosure document providing sufficient information to permit an informed voting decision. §1125(b).

a. A class of creditors has accepted the plan when a majority in number and two-thirds in amount of those creditors actually voting approve the plan. §1126(c).

b. A class of shareholders has accepted the plan when two-thirds in amount of the interests of those voting accept the plan. §1126(d).

3. In order for a plan to be confirmed, it must be approved by each class of creditors and shareholders whose rights the plan alters. §1129(a)(8).

a. Confirmation requires findings by the Court regarding the submission of the plan in good faith and its compliance with applicable law. §§1129(a)(1)-(3).

b. Findings are also required on the feasibility of the plan and a variety of other matters. §§1129(a)(11); 1129(a).

4. A plan may be confirmed despite non-acceptance of an impaired class if the Court finds the plan meets the so-called "cramdown" requirements. §1129(b).

a. In order to be crammed down, the plan must not discriminate unfairly against the dissenting class and must be "fair and equitable." §1129(b)(1).

b. A plan is "fair and equitable" as to a class of unsecured claims if those in the dissenting class receive, under the plan, the present value of their claims <u>or</u> they receive at least the amount they would receive if the debtor were liquidated and no junior claim or interest receives any value. §1129(b)(2)(B).

c. A plan is "fair and equitable" as to a class of secured claims if the class receives a form of payment with a present value equal to the value of the creditors' interest in the collateral, as determined by the Court. §1129(b)(2)(A).

d. The excess of the claim, if any, of any such secured creditor over the value of his interest in the collateral will be treated as an unsecured claim and the creditor will be able to participate with respect thereto along with other unsecured creditors.

VII. POST-CONFIRMATION MATTERS

1. After confirmation of a plan, the Court will retain jurisdiction of the debtor for purposes of ensuring that the plan is implemented in accordance with its terms.

2. However, the debtor will have title to its assets free and clear of claims except those provided in the plan and will otherwise be free to operate it reorganized business as if the proceeding had not taken place. §1141(c).

66th Sixth Circuit Judicial Conference
Panel Session - Employee and Retiree Benefits in Bankruptcy
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Collectively Bargained Employee and Retiree Benefits in Bankruptcy

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* The views expresses in this paper are entirely those of the author and do not necessarily reflect the views or opinions of the UAW or its officers.

I. The Union as a Party-in-Interest and Creditor

A. A Union's Right to be Heard.

1. As a creditor as well as a party-in-interest, a union can be heard on all motions that come before the bankruptcy court. 11 U.S.C. §1109(b).

2. **Receipt of Notice.** Creditors and parties-in-interest may file formal notice with the bankruptcy court requesting service, usually on counsel, of all major court filings. *See* 11 U.S.C. §§107(a), 1109(b); Fed. R. Bankr. P. 2002, 9007, 9010(b).

3. **Labor Unions as Members of Creditors Committees**. Labor unions are deemed to be creditors, with the right to file claims for obligations arising under collective bargaining agreements. Accordingly, it is recognized that unions are entitled to appointment to the creditors committees. *See In re Altair Airlines, Inc.,* 727 F.2d 88 (3d Cir. 1984); *In re Barney's Inc.*, 197 B.R. 431(Bankr. S.D.N.Y. 1996); *In re Enduro Stainless, Inc.,* 59 B.R. 603 (Bankr. N.D. Ohio 1984); *In re Northeast Dairy Cooperative Federation, Inc.,* 59 B.R. 531, 534 (Bankr. N.D.N.Y. 1986); *see also* 2 *Collier on Bankruptcy*, ¶101.09 at 101-51 (15th Ed. Rev. 2005).

B. Union and Employee Claims

1. **The Bankruptcy Code confers priority status to certain employee wage and benefit claims**

   a. **Employee wage priority** –for "wages, salaries or commissions, including vacation, severance, and sick leave pay" earned within 180 days of the bankruptcy filing or date of cessation of business, whichever comes earlier, and only up to $10,000 per individual. 11 U.S.C. §507(a)(4). NOTE: Wages earned pre-petition but paid post-petition may be offset against the $10,000 priority.

   b. **Contributions to an employee benefit plan** – arising from services of employees rendered within 180 days of the bankruptcy filing or date of cessation of the business. The limit on employee benefit priority claims is $10,000, less the aggregate amount paid under the wage priority described above. 11 U.S.C. §507(a)(5). "Employee benefit plan" includes contributions due to a 401(k) or other retirement income plan, as well as health care plans.

2. **Bar Date/Proofs of Claim**. Creditors generally must file proofs of claim to obtain a recovery in the bankruptcy proceeding. Fed. R. Bankr. P. 3002. The bankruptcy court sets a "bar date" by which proofs of claim

must be filed. Unions and employees, like other creditors, must strictly comply with these deadlines. Unions are generally considered "creditors" with the right to file claims under collective bargaining agreements. *In re Altair Airlines*, 727 F.2d 88 (3rd Cir. 1984). Although there are few decisions on point, the status of a union as a "creditor" is generally considered to give the union a right to file a proof of claim on behalf of members of the bargaining unit. In addition, the notion that labor unions act on behalf of their members in collective bargaining matters as predicted under the National Labor Relations Act, provides further support for the right of labor unions to file group claims for all members. *See, e.g. OPEIU Local 2 v. FDIC*, 962 F.2d 63 (D.C. Cir. 1992).

II. The Status of Collective Bargaining Agreements in Bankruptcy

A. Section 1113.

The Bildisco Decision

In *NLRB v. Bildisco and Bildisco*, 465 U.S. 513 (1984), the employer was party to a collective bargaining agreement with the Teamsters Union. Subsequent to filing a Chapter 11 petition (and while the pre-petition CBA remained, by its terms, in effect), the debtor refused to make wage increases mandated under the CBA and otherwise failed to make pay health and retirement income benefit payments. The union filed charges with the National Labor Relations Board arising from the debtor's unilaterally modifying the CBA in failing to make required payments. The debtors moved to reject the CBA under Section 365 of the Bankruptcy Code. The Bankruptcy Court allowed the debtors to reject the CBA.

After a series of appeals, the Supreme Court held that: (1) a collective bargaining agreement could be rejected under Section 365 of the Bankruptcy Code as an "executory contract", and (2) a bankrupt employer did not violate its labor law duties by unilaterally modifying collectively bargained terms and conditions of employment before seeking or obtaining court authorization to reject the agreement. The Court reasoned that a collective bargaining agreement was "no longer immediately enforceable," *Bildisco,* 465 U.S. at 532, once an employer filed for reorganization.

Congress' Response

The *Bildisco* decision heightened and confirmed existing fears that companies were using the "bankruptcy law as an offensive weapon in labor relations," *Adventure Resources, Inc. v. Holland*, 137 F.3d 786, 797-98 (4th Cir. 1998). The decision was met with immediate and fierce opposition by organized labor. *See Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America*, 791 F.2d 1074, 1082-84 (3d Cir. 1986)(examining legislative history). Agreeing that *Bildisco* created a "new and dangerous imbalance in the collective bargaining process," 130 Cong. Rec. H1831 (daily ed. March 21, 1984)(comments of Rep. Vento), Congress enacted Section 1113, which "replace[d] the *Bildisco* standard with one that was more sensitive to the national policy favoring collective bargaining agreements." *Wheeling-Pittsburgh*, 791 F.2d at 1089. *See also*130 Cong. Rec. S8898 (daily ed. June 29, 1984)(comments of Sen. Kennedy)(the intent of the law is "to overturn the *Bildisco* decision which had given the trustee all but unlimited discretionary power to repudiate labor contracts and substitute a rule of law that encourages the parties to solve their mutual problems through the collective bargaining process").

The Section

Briefly, Section 1113 prohibits unilateral changes to a CBA and requires that a collective bargaining agreement may be modified or rejected only in accordance with the procedural and substantive requirements of that Section.

1. **No Unilateral Changes to a CBA.** Section 1113 prohibits the use of any provision of the Bankruptcy Code to unilaterally terminate or modify a collective bargaining agreement (absent compliance with Section 1113). 11 U.S.C. §1113(f). This provision has far-reaching implications on the CBA. For example:

    a. **Compliance with grievance/arbitration provisions of the CBA -** Courts have interpreted Section 1113(f) to require a debtor to arbitrate any and all grievances, including pre-petition grievances, upon demand and notwithstanding §362 (the automatic stay provision). *See, e.g., In re Ionosphere Clubs*, 922 F.2d 984 (2nd Cir. 1990), *cert. denied sub num. Air Line Pilots Ass'n v. Shugrue*, 112 S. Ct. 50 (1991)(the automatic stay does not apply to labor agreement arbitration).

    b. **Section 1113(f) "Superpriority" Claims** – Because Section 1113(f) clearly provides that no provision of the bankruptcy code "shall be construed to permit a [debtor] to unilaterally terminate or alter any provision" of a CBA prior to compliance with Section 1113, the Sixth Circuit held that claims arising under an unrejected CBA are entitled to immediate payment in full regardless of qualification as administrative expenses under Section 503(b). *In re Unimet Corp.*, 842 F.2d 879 (6th Cir. 1988), *cert. denied* 488 U.S. 828 (1988).

2. **Rejection of a CBA under Section 1113.** Under Section 1113, a debtor seeking to reject a collective bargaining agreement must meet the following requirements:

    a. The debtor must make a proposal to the union, based on the most complete and reliable information available, which provides for those necessary modifications in employee benefits and protections that are necessary to permit the reorganization of the debtor;

b. The union must reject the proposal without good cause; and
c. The balance of the equities clearly favors rejection of such agreement.

11 U.S.C. §1113(c).

In interpreting the statutory requirements listed above, courts have used Section 1113 (b) and (c) to develop the following nine-factor analysis:

i. The debtor must make a proposal to the union to modify employee benefits and protections;
ii. The proposal must be based on the most complete and reliable information available at the time;
iii. The proposed modifications must be necessary to permit the reorganization of the debtor;
iv. The proposed modifications must assure that all creditors, the debtor and all affected parties are treated fairly and equitably;
v. The debtor must provide the union with such relevant information as is necessary to evaluate the proposal;
vi. Between the time of making the proposal and the time of the hearing on rejection of the CBA, the debtor must meet at reasonable times with the union;
vii. At the meetings, the debtor and union must confer in good faith in attempting to meet a mutually satisfactory modification to the CBA;
viii. The Union's refusal to accept the proposal must be without good cause; and
ix. The balance of the equities must clearly favor rejection of the CBA.

See, e.g., In re American Provision Co., 44 B.R. 907 (Bankr. D. Minn. 1984); *In re National Forge Co.,* 289 B.R. 803 (Bankr. W.D. Pa. 2003). The debtor must establish *each* element by a preponderance of the evidence. *In re National Forge*, 289 B.R. at 810.

Right to strike upon rejection. Contract rejection gives the union the legal right to strike. *Briggs Trans. Co. v. I.B.T.*, 739 F.2d 341 (8^{th} Cir. 1984).

3. **Rejection Standards under Section 1113.** The standards enumerated above have been litigated extensively since Section 1113 was enacted. As such, a body of law has developed in interpreting and applying the standards in connection with a specific debtor's request to reject a CBA.

   a. **The Necessity Requirement.** What are "necessary" changes? The Third Circuit holds that "necessary" means "essential" to prevent liquidation, and is not related to "general long term viability" *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d 1074 (3d Cir. 1986). The Second Circuit holds that "necessary" means more than desirable but less than what is needed to avoid collapse; hence the changes need not be absolutely minimal. *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82 (2d Cir. 1987). Under the Second

Circuit's approach to defining necessary, a debtor's proposal "need not be limited to the bare bones relief than will keep it going." *In re Royal Composing Room, Inc.*, 848 F.2d 345, 350 (2d Cir. 1988).

b. **Fair and Equitable Standard**. This provision was enacted to "spread the burdens of saving the company to every constituency while ensuring that all sacrifice to a similar degree." *In re Century Brass Products, Inc.*, 795 F.2d 265, 273 (2nd Cir. 1986). Courts have found that all parties must make some concessions, not just workers. *See, e.g., In re Kentucky Truck Sales*, 52 B.R. 797, 802 (Bankr. W.D. Ky. 1985).

c. **Complete and Reliable Information Requirement**. This provision is meant to allow the union to evaluate the debtor's proposal and bargain as an informed agent. As such, the debtor is required to respond to the union's reasonable requests for information and otherwise provide it with financial information necessary to evaluate the necessity of the proposed concessions *and* frame counter-proposals. The failure to provide information requires denial of the Section 1113 motion. *In re K&B Mounting*, 50 B.R. 460 (Bankr. N.D. Ind. 1985). *See also In re George Cindrich General Contracting*, 130 B.R. 20 (Bankr. W.D. Pa. 1991)(stale information was inadequate under this subsection).

d. **Balance of the Equities Favors Rejection.** The debtor is required to show clear and convincing proof. The list of equities which should "be balanced" include:

   i. The likelihood and consequences of liquidation if rejection is not permitted;
   ii. The likely reduction in the value of creditors' claims if the bargaining agreement remains in force;
   iii. The likelihood and consequences of a strike if the bargaining agreement is voided;
   iv. The possibility and likely effect of any employee claims for breach of contract if rejection is approved;
   v. The cost-spreading abilities of the various parties, taking into account the number of employees covered by the bargaining agreement and how various employees' wages and benefits compare to those of others in the industry; and
   vi. The good or bad faith of the parties in dealing with the debtor's financial dilemma.

NLRB v. Bildisco, 465 U.S. 513 (1984).

B. **Section 363 Asset Sales**. The Bankruptcy Code allows a chapter 11 debtor to sell some or all of its assets as a going concern "free and clear" of all liens or interests. 11 U.S.C. §363(c) and (f). Hence, a debtor could sell a plant or business (whose hourly employees are subject to a collective bargaining agreement) without the purchaser assuming the operative labor agreement or any obligations arising thereunder. The rationale behind Section 363 sales is that a debtor must maximize returns for its creditors, and restricting the sale of assets to assumption of certain obligations could adversely affect the debtor's ability to market or sell such assets. Unions may seek to block such "free and clear" sales if such transactions would violate the terms of an existing collective bargaining agreement. *See, e.g., In re Lady H Coal Co.*, 199 B.R. 595 (Bankr. S.D. W.Va. 1996)(section 363 sale of assets in violation of collective bargaining agreement may result in administrative claim against estate for damages); *In re Stein Henry Co.*, 1992 WL 122902 (Bankr. E.D. Pa. 1992)(pursuant to Section 1113, a plan of reorganization must provide for compliance with contractual successorship provision). *See also Am. Flint Glass Workers v. Anchor Resolution*, 197 F.3d 76, 81-82 (3d Cir. 1999)(a debtor's negotiation of a provision in an asset purchase agreement that "binds itself contractually to obtain a change in the legal relations created by a collective bargaining agreement as a condition precedent to closing a sale of substantially all of the debtor's assets" is an "attempt to effect an alteration of the CBA" and implicates the requirements of Section 1113).

III. Retiree Health Care Benefits in Bankruptcy – Section 1114

A. **Background and History.** The Retiree Benefits Bankruptcy Protection Act, which has been codified as Section 1114 of the Bankruptcy Code, was enacted in response to the first bankruptcy filing of LTV Steel. In 1986, LTV filed a chapter 11 bankruptcy petition and then notified some 78,000 retirees that it was terminating their collectively bargained retiree health care and life insurance benefits. Congress acted swiftly in enacting Section 1114. *See* 11 U.S.C. §1114(e)(providing that the debtor "shall timely pay and shall not modify any retiree benefits" except as provided therein).

As stated in the legislative history, the enactment of Section 1114 would make clear that the debtor "may never unilaterally cut off retiree insurance benefits," because "the burden of turning a company around should not rest on the backs of retirees." *In re Ionosphere Clubs, Inc.*, 134 B.R. 515, 522 (Bankr. S.D.N.Y. 1991)(*quoting* 134 Cong. Rec. S6823, S6825(daily ed. 1988))(statement of Sen. Metzenbaum). Congress determined to protect retirees in this manner because:

> [c]ancellation of health insurance is a serious matter for anyone. It is especially serious for a retiree who is too young for Medicare but too old to buy affordable health coverage. While healthy retirees may find a replacement policy for a hefty monthly premium, sick retirees may be unable to find one at any price. The thought that a company could enter bankruptcy and renege on the promise of health and life insurance *without a moment's hesitation or so much as a word to the retirees* was troubling to the Congress.

134 Cong. Rec. S6940 (daily ed. May 27, 1986)(statement of Sen. Heinz)(emphasis added).

B. **Representation and Coverage Issues.**

Both union and non-union retirees are covered. Section 1114 provides that the debtor "shall timely pay and shall not modify any retiree benefits" unless the debtor follows the procedures of Section 1114 and gains court approval. 11 U.S.C. §1114(e)(1).

Retiree benefits are defined as payments to "any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents" for medical benefits, hospital benefits, death benefits, etc. 11 U.S.C. §1114(a).

Unions Presumed to Act As Retiree Representatives. Section 1114(c)(1) provides that a labor organization shall be the "authorized representative" of persons receiving retiree benefits pursuant to a collective bargaining agreement to which the labor organization is a signatory "unless (A) such labor organization elects not to serve as the authorized representative of such persons, or (B) the Court, upon motion by any party in interest, after notice and hearing, determines that different representation of such persons is appropriate.

Non-union Retirees. The court may appoint a committee of retired employees for those persons receiving retiree benefits not covered by a collective bargaining agreement. 11 U.S.C. §1114(d).

C. **General Provisions**. Section 1114 generally parallels Section 1113 with respect to the procedural and substantive requirements a debtor must meet in order to obtain relief from its retiree health care obligations, i.e., it requires the debtor to make a proposal, provide relevant information, meet in good faith, etc. In addition, the court must find that all parties are treated fairly and equitably, that the equities tip in favor of modification, etc.

PBGC's Role in Bankruptcy

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April 2006[1]

1. Introduction to PBGC

A. PBGC is governed by a board consisting of the Secretaries of Labor, Treasury, and Commerce, and administered by an Executive Director and his staff. It was designed to be self-financing. Though PBGC is an agency of the United States government, it is not backed by full faith and credit of the United States.

B. PBGC is financed by premiums paid by ongoing pension plans, or by the employers that sponsor them. The premium rates are $30 per person plus $9 per $1000 of underfunding for vested benefits.[2]

C. PBGC insures about 30,000 pension plans (both single-employer and multiemployer) covering about 44 million people. Insured benefits approach $2 trillion. Underfunding in covered plans exceeds $450 billion. PBGC has taken over about 3,600 plans since 1974. As a result, PBGC is responsible for paying benefits, now or in future, to more than 1.3 million people. In FY 2005, PBGC paid about $3.7 billion in benefits.

D. As of September 30, 2005, PBGC's single-employer program has a deficit of $22.8 billion (net of subsequent events). As recently as FY 2001, PBGC was in surplus. PBGC's financial position is a function

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[1] Opinions expressed do not necessarily represent the official position of the PBGC.

[2] In the Deficit Reduction Act of 2005, in addition to increasing the flat rate premium from $19 to $30, Congress added a three-year $1250 per person premium for terminated plans. See http://www.pbgc.gov/media/news-archive/2006/pr06-26.html

of interest rates, investment returns, and the business cycle. Industries that account for most of the claims against the insurance system are steel (53%) and airlines (14%), although those industries together account for less than 5% of covered participants. Major claims in recent years include Bethlehem, LTV, and National Steel, and United Airlines and US Airways.

E. For an overview of the program, and the stresses it is subject to, see 2005 PBGC Performance and Accountability Report http://www.pbgc.gov/docs/2005par.pdf

2004 Pension Insurance Data Book http://www.pbgc.gov/publications/databook/databook04.pdf

Executive Director Bradley Belt's testimony before the Aviation Subcommittee of the House Committee on Transportation and Infrastructure (June 22, 2005) http://www.pbgc.gov/media/news-archive/ExecutiveTestimony/tm13159.html[3]

2. Defined Benefit Plans

A. Defined benefit plans promise a fixed benefit for life, such as 1-1/2 percent of final pay times years of service for life (with 30 years, 45% of final pay per year). Union plans may use a flat multiplier instead, such as $40 per month per year of service.

B. In a defined contribution plan, the employee owns an account and is entitled to the account or to the annuity it will buy at retirement, so the investment risk is on the employee. By contrast, in a defined benefit plan, investment risk is on the employer, and on PBGC.

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[3] Pension reform bills have been passed by the House and Senate, H.R. 2830 (Pension Protection Act of 2005), and S. 1783 (Pension Security and Transparency Act of 2005).

3. Funding

A. Defined benefit plans are not required to be fully funded, and are permitted to be funded over time, on the theory that the plan is intended to be permanent. So, for example, each time benefits are increased or each year there is an investment loss, there is a charge that must be amortized over a period of years. There is generally a charge for normal cost, a measure of benefits earned in the current year. An investment or mortality gain would be a credit.[4]

B. Each year, the plan's actuary calculates the net charges or credits, and if there is a net charge, there is a new amount to be amortized. There is an additional required contribution for severely underfunded plans, called the deficit reduction contribution ("DRC"). An amortizing portion of the net charge for the past year, plus amortizing portions of the charges for previous years, plus the DRC, make up that year's minimum funding.[5]

C. The required amount is payable in quarterly installments, plus a catch up 8-1/2 months after the close of the plan year (usually Sept 15). If missed payments exceed $1M, there is a lien on all property of the plan's sponsor and all controlled group members (80% commonly owned), perfectible and enforceable by PBGC.[6]

4. Termination

A. ERISA specifies that a defined benefit plan can be terminated in only three ways. If the plan is fully funded, it can be closed out in a standard termination, by buying annuities or (if the plan document permits) paying lump sums, in full satisfaction of all benefit claims.[7] If the plan is not fully funded, but the employer and all members of the controlled group show they

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[4] See 29 U.S.C. § 1082(b).

[5] See 29 U.S.C. § 1082(b), (d).

[6] 29 U.S.C. § 1082(e), (f).

[7] 29 U.S.C. § 1341(a), 1341(b)(3).

cannot afford the plan, it can be terminated in a distress termination.[8] Finally, if the plan fails the minimum funding standard or will be unable to pay benefits when due, or PBGC deems itself at undue risk of increased loss, PBGC can initiate termination.[9]

B. If a plan is terminated in a distress or PBGC-initiated termination, the sponsor and the controlled group are jointly and severally liable to PBGC for the shortfall between the value of benefits in today's dollars and the market value of plan assets (the unfunded benefit liabilities, or "UBL").[10] In that case, PBGC takes over the plan as statutory trustee, and pays retirees the benefits they have earned up to the termination date, subject to limits in ERISA. For example, there is an indexed dollar maximum, about $48,000 per year for terminations in 2006; the maximum is scaled back for each year below age 65 (to less than half at age 55). Benefits that are less that 5 years old are guaranteed on a phased in basis, only 20% per year between adoption/effective date and plan termination.[11]

5. Reportable Events and Monitoring

A. ERISA requires the plan administrator to notify PBGC within 30 days after certain events that increase the plan's risk profile. Obviously, bankruptcy is one of them. There is a civil penalty of up to $1100 per day for failing to make the report.[12] PBGC also finds out about bankruptcies from Bloomberg, various credit and bankruptcy news services, and US Attorneys' offices.

B. PBGC also monitors financially troubled companies, and those with significantly underfunded pension plans. Among the events and transactions that concern PBGC are controlled group breakups, spinoffs of

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[8] 29 U.S.C. § 1341(c).

[9] 29 U.S.C. § 1342(a).

[10] 29 U.S.C. §§ 1301(a)(18), 1362(a), (b).

[11] 29 U.S.C. §§ 1322(a), (b), 1342(d).

[12] 29 U.S.C. §§ 1343(a), (c)(10); 29 CFR § 4043.45; 29 U.S.C. § 1371.

significant pension liabilities, LBOs, divestitures, extraordinary dividends, and refinancing with secured debt. These transactions may put the insurance system at greater risk than before. As a result, they may give PBGC reason to consider terminating the pension plan before the transaction, under ERISA's long-run loss standard.

C. PBGC has negotiated for protections to pension plans and the insurance system in lieu of plan termination. This has taken the form of advance contributions to the pension plan, security for pension liabilities (a lien or a letter of credit), a guaranty of pension liabilities by the departing controlled group member, and assumption of the plan by the stronger controlled group member.

6. Creditors' Committees

A. Under the 1994 Bankruptcy Code amendments, PBGC is authorized to be a voting member of an unsecured creditors committee.[13] There will often be a large contingent claim for the UBL, and in some cases PBGC is one of the largest unsecured creditors.

B. PBGC has served on creditors committees in bankruptcies in diverse industries. Among them are Harvard Industries (Bankr. D. N.J.), Kaiser Aluminum (Bankr. D.Del.), KMart (Bankr. N.D.Ill.), Polaroid (Bankr. D.Del.), Warnaco (Bankr. S.D.N.Y), Delphi (S.D. N.Y) (ex officio), Reliance Group (Bankr. S.D.N.Y.), LTV (Bankr. N.D. Ohio), Bethlehem (Bankr. S.D.N.Y.), National Steel (Bankr. N.D. Ill.), United Airlines (Bankr. N.D. Ill.), Hawaiian Air (Bankr. D. Haw.), Delta Airlines (S.D. N.Y.), Consolidated Freightways (Bankr. C.D. Cal.), Huffy (Bankr. S.D. Ohio), and Murray (Bankr. M.D. Tenn.).

7. Minimum Funding During Bankruptcy

A. Two courts of appeals have held that minimum funding that accrues post-petition or during the 180-day priority period has no priority except to the extent of normal cost, an actuarial measure that has some resemblance to

[13] See 11 U.S.C. §§ 101(41)(B), 1102(b)(1).

the cost of benefits accrued in that year.[14] Those courts have also rejected ERISA's rule that where unpaid contributions exceed $1M they are entitled to tax treatment in bankruptcy.[15]

B. Nevertheless, debtors that intend to continue their plans often provide for quarterly and annual contributions under first-day motions, along with other employee benefit payments. Though a plan is a legal entity, and not an executory contract, debtors will often provide in the plan of reorganization for assumption of the pension plan. That of course entails a cure of any default under section 365. More commonly, there is simply a "ridethrough."

C. In other cases, however, the issue has been hard fought. In WCI Steel, for example, the secured creditors asserted that required contributions would be post-petition preferences, avoidable under 11 U.S.C. § 549, and sought disgorgement by the pension plan and an injunction against future contributions. The court held otherwise, as the contributions in that case were required by a collective bargaining agreement, and were therefore required by 11 U.S.C. § 1113(f) and not prohibited by § 549.[16]

D. If a plan fails the minimum funding standard, there is a 10% (and if not cured, 100%) excise tax on the sponsor and controlled group.[17] On the other hand, if the sponsor and controlled group can show IRS that they are suffering merely a temporary business hardship, they may obtain a waiver of the year's funding contribution, which is then amortized over the next five years.[18]

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[14] In re CF&I Fabricators of Utah, 150 F.3d 1293 (10th Cir. 1998); In re Sunarhauserman, 126 F.3d 811 (6th Cir. 1997).

[15] 29 U.S.C. § 1082(f). See CF&I, n. 12 supra, and Belfance v. PBGC (In re CSC Industries), 232 F.3d 505 (6th Cir. 2000).

[16] Wilmington Trust v. WCI Steel (In re WCI Steel), 313 B.R. 414 (Bankr. N.D. Ohio 2004).

[17] 26 U.S.C. § 4971.

[18] 26 U.S.C. §§ 412(b)(2)(C), (d).

8. Asset Sales

A. PBGC watches asset sales closely, especially those of subsidiaries, as liability under ERISA is joint and several. Any disposition of sale proceeds could be a sub rosa plan of reorganization. And if the subsidiary is not in bankruptcy, it is unclear whether the court even has jurisdiction to approve the disposition of proceeds, much less to approve the sale free and clear.

B. PBGC has been able to negotiate standstills as to the disposition of proceeds in some cases, such as Laclede Steel (Bankr. E.D. Mo.), Enron (Bankr. S.D. N.Y.), Ingersoll (Bankr. N.D. Ill.).

9. Distress Termination

A. If all debtors will be unable to meet minimum funding based on their projected cash flow, they may apply to the bankruptcy court for approval of plan termination, on notice to PBGC. If the court finds that they could reorganize but for the pension funding, the court may find "distress." If PBGC has not objected, and if all non-debtor controlled group members also meet distress, the plan can be terminated.[19]

B. A distress termination cannot be done under ERISA if a collective bargaining agreement arguably prevents termination, for example if it provides that the pension plan will be continued for the duration of the contract.[20] Consequently, the debtor may try to get the union to drop this contract bar as part of a § 1113 process.

C. The reported cases are often clearcut,[21] but in US Airways there was a

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19 29 U.S.C. § 1341(c)(2)(B)(ii).

20 See 29 U.S.C. § 1341(a)(3).

21 E.g., In re Sewell Corp, 195 B. R. 180 (Bankr. N.D. Ga. 1995). But see In re Philip Services Corp., 310 B.R. 802 (Bankr. S.D. Tex. 2004) (distress finding denied, despite debtor's assertions that projected capital expenditures and debt repayment would not leave enough free cash to meet minimum funding, and exit lender's threat not to close unless pension plans were terminated).

lengthy trial on the issue.[22] Each debtor and other controlled group member must show distress, and as to each plan separately.[23]

10. PBGC-initiated Terminations in Advance of Shutdowns, Asset Sales, and Controlled Group Breakups

A. Plans in the steel and auto industries often provide early retirement benefits, such as 30 and out, where the employee can receive a benefit for life starting in his early 50s or even late 40s. If the benefit is the same per month as it would be at age 65 – actuarially subsidized -- it is very expensive. These plans often provide a shutdown benefit, the right to an early out even with less than 30 years service, for those who lose their jobs or are laid off due to a plant closing or a downsizing and who meet a point system (e.g., age and service total 80, or total 65 and employee has no bumping rights into a suitable job).

B. A looming shutdown/layoff is a classic event that may increase PBGC's risk of loss unreasonably, especially since these benefits aren't funded in advance and by law cannot be. So is a stock sale that would remove a healthy parent or subsidiary from the controlled group, or an asset sale where the proceeds may be upstreamed as a liquidating dividend. In several cases, PBGC has acted to terminate a plan on these facts.[24] In PBGC v. RTI, the district court held that the effective termination date of the plan could not be before shutdown, as a matter of balancing employees' interests with those of PBGC's premium payers. The Sixth Circuit reversed, agreeing with every other circuit that PBGC is entitled to set the plan

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22 In re US Airways Group, 296 B.R. 734 (Bankr. E.D. Va. 2003) (pilots plan). See also In re US Airways Group, No. 04-13819 (Bankr. E.D. Va. Jan. 6, 2005) (flight attendants and machinists plans).

23 In some cases, courts have considered pension plans in the aggregate. E.g., In re Kaiser Aluminum, 2005 US DIST LEXIS 5016, 34 EBC 2208 (D. Del. Mar. 30, 2005), appeal docketed, No. 05-2695 (3d Cir. June 8, 2005).

24 PBGC's authority to terminate a plan based on unreasonable increase in long-run loss was upheld in PBGC v. FEL Corp., 798 F. Supp. 239 (D.N.J. 1992).

termination date by giving notice to participants.[25]

11. Post-Termination Benefits

A. Under ERISA, PBGC can restore a terminated plan, or stop a termination in process, where that would promote the purposes of the insurance program.[26] The only reported decision arose in the course of the first LTV case (In re Chateaugay Corp., Bankr. S.D.N.Y.). There, PBGC restored LTV's plans to LTV after LTV adopted follow-on arrangements that substantially replaced benefits lost when its pension plans terminated, but with a government subsidy. After losing in the lower courts, including the Second Circuit, PBGC prevailed in the Supreme Court.[27] After the Supreme Court ruling, LTV and other stakeholders restructured their proposals, and eventually a settlement was reached that allowed LTV to emerge from bankruptcy. The broader policy and legal issues associated with post-termination arrangements remain a matter a great concern.[28]

B. Many bankruptcies result in asset sales. The norm in the pension world is that you can't double dip, both work and draw a pension from the same employer. In the case of a stock sale, or a debt for equity swap, the employer remains the same. But in the case of an asset sale, at least under traditional corporate law, the buyer is a different entity. Under PBGC's working retirement policy, an employee can draw a pension from PBGC under the terminated plan if she works for an asset purchaser as long as the plan document doesn't preclude it.

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25 PBGC v. Republic Technologies International, LLC, No. 5:02CV01116 (N. D. Ohio Sept. 30, 2003) (slip op.), rev'd 386 F.3d 659 (6th Cir. 2004), cert. denied, 125 S. Ct. 1594 (2005). RTI was sold as a going concern, but an asset sale is arguably a shutdown, at least in the USWA's view. See Varhola v. Doe (6th Cir. 1987).

26 29 U.S.C. § 1347.

27 PBGC v. LTV Corp., 496 U.S. 633 (1990).

28 For a synopsis, see Remarks of Bradley D. Belt at the University of Texas School of Law VALCON Conference, http://www.pbgc.gov/media/news-archive/ExecutiveSpeech/sp15672.html

12. Claims

A. One of the most controversial issues is determination of the amount of a claim for the shortfall of a terminated plan, the UBL. Starting with the first LTV case, three courts have held that the present value of benefits is determined by using a projected rate of return on a hypothetical portfolio of stocks and bonds.[29]

B. The bankruptcy court disagreed in the first US Airways case. There, the Plan had a shortfall of about $2.2B under PBGC assumptions, which are specified by ERISA and regulations and are designed to replicate the cost of a private sector annuity contract.[30] US Airways asserted that the claim was only about $900M, based on a projected 8% return from a diversified hypothetical portfolio.

C. In the previous cases, PBGC lost because of the principle of equality of distribution among creditors, and the bankruptcy court's duty to determine claims. But those are fairly vague notions. Section 502 doesn't specify a source of law for determining claims, though it does provide nine grounds for disallowance. Section 1123(a)(4) requires pro rata payment within classes, but doesn't govern determination of claims. Rather, the general principle is set out on the Supreme Court's decision in Raleigh,[31] that the source of law in bankruptcy is nonbankruptcy law, though Congress can displace nonbankruptcy law by a specific provision of the Code. The bankruptcy court in US Airways agreed.[32]

D. Even putting aside these rules of law, a liability is valued based on its own risk characteristics, not on the potential earnings of a corresponding asset. For example, if you lend me $100 payable in one year at 6% simple

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29 In re Chateaugay, 126 B.R. 165 (Bankr. S.D.N.Y 1991), vacated, 1993 WL 388805 (S.D.N.Y. 1993); CF&I Fabricators and Belfance, supra nn. 14, 15.

30 29 U.S.C. § 1301(a)(18); 29 C.F.R. § 4044.41 et seq.

31 Raleigh v. Illinois Dep't of Revenue, 530 U.S. 15 (2000).

32 In re US Airways Group, 303 B.R. 784, 793 (Bankr. E.D. Va. 2003). Accord In re UAL Corp., No. 02 B 48191 (Bankr. N.D. Ill.) (Tr. Dec. 16, 2005 at 31-38).

interest, I can buy lottery tickets, I can buy stocks, or I can buy Treasuries, but in one year I will owe you exactly $106 no matter what my earnings are. If I want to hedge my liability, I would buy Treasuries. If there were an insurer who would take the liability off my hands, I could pay him the going rate, which is presumably $100. That, in brief, was the expert testimony on PBGC's side in US Airways, which the bankruptcy court accepted.[33]

13. Reorganization Issues

A. PBGC is usually concerned with whether the pension plan will continue or terminate. If the debtors are able to continue the pension plan, PBGC would expect the disclosure statement and the reorganization plan to so provide. If not, PBGC would seek to clarify at the disclosure stage.

B. If the plan has terminated, or may terminate, there are a number of provisions that cause particular concern. Substantive consolidation is a common feature of reorganization plans for complex enterprises. Because liability under ERISA is joint and several, substantive consolidation can have the effect of reducing PBGC's recovery, by giving it one recovery instead of several. Even smallish subsidiaries may have a substantial surplus, at least before the pension claim is factored in, and that claim should be paid before upstreaming the subsidiary's assets to the parent.[34]

C. Another concern is release of directors and officers, since they may be ERISA fiduciaries, and as trustee PBGC inherits any claims for breach of fiduciary duty under ERISA.[35]

D. Usually, PBGC's claims are not separately classified, but instead fall

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[33] 303 B.R. at 797.

[34] See, e.g., In re New York Commercial Corp., 233 F. 906 (2d Cir. 1916) (joint and several claim against two insolvents is entitled to a dividend from each estate, subject to the one satisfaction rule); 11 U.S.C. § 1129(b)(2)(B)(ii) (the absolute priority rule, codifying the principle that debt takes before equity).

[35] 29 U.S.C. § 1342(d). For a discussion of the basis for personal liability where the corporate employer is the plan fiduciary, see In re Enron Securities, Derivative & ERISA Litigation, 284 F.Supp. 2d 511, 567-571 (S.D. Tex. 2003).

into the section 507(a)(1), (a)(4), (a)(8) (current codification),[36] or general unsecured pots. Any separate classification (unless part of a settlement) would be objectionable.

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36 To be recodified as 507(a)(2), (5), and (8), under BAPCPA 2005 amendments.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	**Chapter 11**
	:	
NVF Company, et al.,	:	**Case No. 05-11727 (PJW)**
	:	
Debtors.	:	**Jointly Administered**
	:	
	:	**Objection Deadline: September 16, 2005 @ 4:00 p.m.**
	:	**Hearing Date: September 23, 2005 @ 3:00 p.m.**

MOTION OF DEBTOR AND DEBTOR IN POSSESSION FOR AN ORDER AUTHORIZING THE REJECTION OF A COLLECTIVE BARGAINING AGREEMENT PURSUANT TO SECTION 1113 OF THE BANKRUPTCY CODE

NVF Company, as debtor and debtor in possession ("NVF"), hereby moves the Court, pursuant to section 1113 of title 11 of the United States Code, 11 U S C §§ 101-1330 (the "Bankruptcy Code"), for an order authorizing it to reject that certain Agreement between NVF and United Paperworkers International and its Affiliate Fibre, Plastic and Machine Local 770 (the "Union"),[1] as amended (the "CBA"). NVF seeks this relief because (i) it has made proposals to the Union providing for modifications to the CBA, specifically relating to pension benefits, medical benefits and work rules, that are necessary to permit the reorganization of NVF, assure that all stakeholders and affected parties are treated fairly and equitably, and are clearly favored by the balance of the equities and (ii) the Union has affirmatively rejected NVF's proposal for necessary modifications without good cause In its proposal to the Union, NVF sought only to modify pension funding and medical and other benefits of the CBA and modify certain burdensome work rules set forth therein However, because section 1113 of the Bankruptcy Code does not permit limited modification of the CBA, NVF has no choice but to move for rejection of the CBA in its entirety. In support of this Motion, NVF respectfully represents as follows:

[1] The Union is now known as the United Steel Workers (PACE).

Jurisdiction

The Court has jurisdiction over this matter pursuant to 28 U S C §§ 157 and 1334. This is a core proceeding pursuant to 28 U S.C. § 157(b)(2) Venue is proper before this Court pursuant to 28 U S.C §§ 1408 and 1409.

Background

1. On June 20, 2005 (the "Petition Date"), NVF and its wholly-owned subsidiary, Parsons Paper Company, Inc. ("Parsons," and together with NVF, the "Debtors") each filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code The Debtors continue to manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code On July 8, 2005, the United States Trustee appointed an Official Committee of Unsecured Creditors (the "Committee") in the Debtors' chapter 11 cases.

2. NVF was originally incorporated in 1905 as the National Fibre and Insulation Company From its inception through late 2004, the mainstay of NVF's operations was the production of vulcanized fiber, which is a converted cellulose product with valuable insulation properties In addition to vulcanized fiber, NVF manufactured high pressure industrial laminates, printed circuit boards and custom-made commercial containers for use in various industries. NVF also specialized in fabricating the numerous materials it manufactured for use by end-users primarily in the United States and Canada.

3 Parsons was founded in 1853 and was the first paper mill in the city of Holyoke, Massachusetts. Although Holyoke became a major paper manufacturing center during the latter half of the 19th century, during the 20th century many paper making operations in Holyoke were rendered obsolete by improvements in modern technology. As of 1999, Parsons was the only remaining paper mill still operating in Holyoke Parsons was able to survive the downfall of the domestic paper industry primarily as a result of its niche strategy of focusing on

high-end products such as fine grade writing and technical paper and specialty products such as calendar roll paper[2] and art paper

4. NVF's corporate headquarters and main manufacturing facility are located in Yorklyn, Delaware (the "Yorklyn Facility"). NVF also owns land and manufacturing facilities in Kennett Square, Pennsylvania (the "Kennett Square Facility"), Wilmington, Delaware (the "Wilmington Facility") and Holyoke, Massachusetts (the "Holyoke Facility," and together with the Yorklyn Facility, the Kennett Square Facility and the Wilmington Facility, the "Facilities") Although the Holyoke Facility is owned by NVF, until the closure of the Holyoke Facility in 2004, the Holyoke Facility was leased to Parsons on a monthly basis for use in Parsons' business operations

5. Due to a number of complicating factors, including market deterioration, price competition, union disputes, and failed sale attempts, over the past five years the Debtors have been forced to sell off certain properties, sell off certain segments of their businesses and cease all other operations, resulting in the closure of each of the Facilities As a result, as of the Petition Date, there is no production at any of NVF's remaining facilities (i.e., the Yorklyn Facility, the Kennett Square Facility, the Wilmington Facility and the Holyoke Facility).

6. NVF's restructuring plan relies primarily on (i) the benefits to be derived from a prepetition agreement (the "Agreement") between NVF and Massachusetts based Suddekor LLC ("Suddekor"), pursuant to which NVF will manufacture a new vulcanized fiber product known as "Yorkite Veneer" (patent pending) ("Veneer") for worldwide sale and distribution by Suddekor and (ii) a reduction in costs associated with NVF's unionized workforce With adequate funding to resume manufacturing operations at the Yorklyn Facility,

[2] Calendar roll paper is used by paper manufacturers during the last step of paper production. Newly made paper is fed through a stack of calendar rolls, which compresses the fibers, imparting surface smoothness and finish. Parsons was the primary manufacturer of calendar rolls for the entire Holyoke paper making industry.

in addition to instituting certain cost-saving measures, NVF believes it will be able to profitably produce a mixture of low-margin traditional vulcanized fibre products and high-margin Veneer at the Yorklyn Facility. Over time, as demand for Veneer grows, NVF anticipates the potential for reducing production of its traditional products and, ultimately, replacing such products with production of Veneer. NVF's other Facilities and assets will be liquidated or leased in a manner designed to maximize the value of such assets for the benefit of NVF, its estate and creditors

<u>NVF's Unionized Workforce</u>

7 As of the Petition Date, NVF employed approximately 28 employees, 15 of whom were hourly employees and members of the Union.[3] In contrast, as of the Petition Date, NVF had approximately 350 hourly retired employees and beneficiaries receiving pension benefits under the Pension Plan (defined below).[4]

<u>The Need to Modify the CBA</u>

8 The Debtors' reorganization strategy relies upon the Debtors' ability to (i) comply with their budget and (ii) restart operations under the Suddekor transaction. In creating the budget, the Debtors analyzed whether they could afford to maintain their existing medical and pension benefits plans and operate under the cumbersome work rules contained in the CBA. NVF ultimately determined that it could not comply with these terms of the CBA and still reorganize. Specifically, projections indicate that the Veneer business (upon which NVF's reorganization strategy is centered), either alone or in combination with any or all of NVF's other business lines, would not generate cash flow even remotely sufficient to fund NVF's pension benefits obligations. Moreover, NVF cannot afford to maintain its medical benefits

[3] All of NVF's other Union employees working at the Yorklyn Facility have been placed on "layoff status."

[4] In addition to the Pension Plan governing the Union Employees (defined below), NVF maintains four other pension plans (collectively, the "Other Plans") pursuant to which approximately 275 retired salaried and 48 retired hourly employees that are not Union Employees are receiving benefits. NVF has or will be freezing benefit accruals under the Other Plans, as well

plans or follow the work rules imposed by the CBA while still successfully implementing its reorganization strategy

9 Accordingly, the Debtors' budget is premised upon the assumption that NVF will be able to obtain certain concessions from the Union, which are necessary for NVF to return its business to profitability Absent these concessions, NVF will be unable to afford to rehire its workforce and, therefore, restart operations if and when necessary Absent the ability to restart operations, NVF will be forced to liquidate its remaining assets and dissolve either through these proceedings or through conversion of these cases to chapter 7

The Need to Reject the Collective Bargaining Agreements

10 By this Motion, NVF seeks authority under section 1113 of the Bankruptcy Code to reject the CBA, which sets forth NVF's pension benefit obligations, medical benefit obligations and the work rules for Union Employees (defined below) and retirees This Motion is filed for the purpose of removing any contractual bar to NVF's ability to freeze current benefits under the Pension Plan (defined below),[5] terminate medical and other benefits and hire an affordable, qualified workforce

A The Debtor's Obligations Under the CBA

11 Pursuant to the CBA, NVF is obligated to provide various medical, dental, life insurance and disability insurance benefits (collectively, the "Medical Benefits") to Union employees (collectively, the "Union Employees") during the term of their employment [6] Consistent with the CBA, prior to the Petition Date, NVF provided its current Union Employees

[5] "Freezing" the Pension Plan will halt future benefit accruals under the Pension Plan Current beneficiaries will continue to receive benefits, but no new beneficiaries will be added Accordingly, NVF's minimum funding obligations on a going-forward basis will be immediately reduced, albeit, not eliminated

[6] NVF's obligation to provide the Union Employees with Medical Benefits ceased no later than the second month after the Union Employees were placed on layoff status NVF's obligation to provide the Medical Benefits will be automatically reinstated if and when the Union Employees are rehired

with medical, prescription and dental benefits, life insurance, and short term disability benefits mainly through self-funded insurance plans.[7] During operations, NVF's average monthly cost associated with these programs was $156,000. The Debtors anticipate that approximately $150,000 in prepetition Medical Benefit claims remain unpaid as of the Petition Date.

12. Additionally, under the CBA, NVF is obligated to provide various pension benefits (the "Pension Benefits") to retired Union Employees. Accordingly, NVF sponsors, *inter alia*, the Pension Plan for Hourly Paid Employees of the NVF Company Plants in Delaware and Pennsylvania (the "Pension Plan").[8] As of the date of this Motion, all minimum contributions under the Pension Plan have been made, although the Pension Plan remains underfunded. The owner of 100% of NVF's equity (the "Posner Estate"), through one of its affiliates, has funded all of NVF's minimum contributions to the Pension Plan since the inception of these cases. Absent the Posner Estate's voluntary consent to payment of minimum contributions on a going forward basis, NVF will be unable to make future minimum contributions to the Pension Plan and the Other Plans, which contributions will total approximately $1.5 million from the date of this Motion through December 2005.

13. Finally, the CBA by its terms divides the Union Employees into "classifications," which define and limit the type of work each Union Employee may perform. Because Union Employees may only perform work consistent with their classification, regardless of the extent of their skill set, NVF is obligated to employ more than one Union Employee to perform services that might otherwise be performed by a single person (the "Work Rules").

[7] The Debtors still provide current employees with life insurance benefits and short term disability benefits.

[8] The Debtors also sponsor the Employees' Pension Plan of NVF Company, the Pension Plan for Hourly Paid Employees of the NVF Company Plan in Los Angeles, California, the Pension Plan for Hourly Paid Employees of the NVF Company Plan in Broadview, Illinois, and the Holyoke, Massachusetts Plant of NVF Company Pension Plan. The Debtors are not required to maintain any of the Other Plans other than the Pension Plan under the CBA and the Debtors have frozen or will be freezing benefits under such Other Plans.

Compliance with the Work Rules negatively impacts NVF's efficiency and profitability because NVF must utilize and pay more than one Union Employee to do work otherwise suitable for a single person. After significant analysis, NVF has determined that it cannot comply with the Work Rules and still successfully reorganize its business.

B NVF's Negotiations with the Union

14. For the past several months, NVF's representatives have been meeting with the Union in an attempt to reach a negotiated agreement modifying NVF's obligations under the Pension Plan, terminating the Medical Benefit obligations and modifying the Work Rules and certain other obligations in a manner that will allow NVF to formulate a viable plan of reorganization.

15 NVF's representatives met with the Union initially on April 1, 2005 and presented the Union with a written proposal for modification of the CBA at that time NVF's representatives subsequently had in-person and/or telephonic meetings with the Union's representatives on April 5, 2005, April 8, 2005, April 18, 2005, April 25, 2005, April 26, 2005, May 2, 2005, June 23, 2005 and July 12, 2005. During the course of these meetings, NVF provided written proposals to the Union, responded to information requests, considered counter proposals when they were offered, and negotiated in good faith Despite NVF's good faith negotiations and considerable efforts to reach a consensual agreement with the Union, NVF has been unable to reach a negotiated agreement with the Union as of the date of this filing.

Relief Under Section 1113 of the Bankruptcy Code

16 By this Motion, NVF seeks authority under section 1113 of the Bankruptcy Code to reject the CBA, which sets forth the Medical Benefit and the Pension Benefit obligations and the Work Rules for Union Employees. Section 1113 of the Bankruptcy Code establishes procedural and substantive prerequisites for rejection of a collective bargaining

agreement 11 U.S.C. § 1113(b), (c). In order for a court to approve a proposed rejection of a collective bargaining agreement, the following requirements must be met:

> a. The debtor must make a proposal to the union of modifications necessary to its restructuring that is based on the most reliable information available at the time and that assures that all affected parties are treated equitably,
>
> b. the union must reject the proposal without good cause; and
>
> c the balance of equities must clearly favor rejection of the agreement.

See 11 U.S.C. § 1113 (c)

17. In interpreting the requirements summarized above, courts have developed the following nine-factor analysis: (1) the debtor in possession must make a proposal to the union to modify the collective bargaining agreement, (2) the proposal must be based on the most complete and reliable information available at the time of the proposal; (3) the proposal must be necessary for accommodating the confirmation of a chapter 11 plan of reorganization, (4) the proposal must assure that all creditors, the debtor and all affected parties are treated fairly and equitably; (5) the debtor must provide the union with relevant information necessary to evaluate the proposal; (6) the debtor must meet at reasonable times with the union after making the proposal but before the time of the hearing; (7) the debtor must confer with the union in good faith in an attempt to reach an agreement, (8) the union must have refused to accept the proposal without good cause; and (9) the balance of the equities clearly must favor rejection of the collective bargaining agreement. *See In re National Forge Co.*, 289 B.R. 803, 809-811 (Bankr. W.D. Pa. 2003); *In re Jefley, Inc.*, 219 B.R. 88, 92-93 (Bankr. E.D. Pa. 1998); *In re Bowen Enters., Inc.*, 196 B.R. 734, 741 (Bankr. W.D. Pa. 1996); *In re The Lady H Coal Co., Inc.*, 193 B.R. 233, 241 (Bankr. S.D. W. Va. 1996), *In re Garofalo's Finer Foods*, 117 B.R. 363, 370 (Bankr. N.D. Ill. 1990); *In re Amherst Sparkle Market, Inc.*, 75 B.R. 847, 849 (Bankr. N.D. Ohio

1987); *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

18. As explained below and as will be demonstrated at the hearing on this Motion, NVF has fully complied with the procedural and substantive requirements of section 1113 of the Bankruptcy Code necessary to obtain the relief requested herein, or will have done so by the time of the hearing.[9]

NVF Has Made Written Proposals to the Union

19. NVF has complied with this requirement by submitting a written proposal to the Union and by revising its proposal as necessary when new data became available. Specifically, NVF submitted a written proposal to the Union on April 1, 2005 and has submitted revised proposals orally to the Union at various meetings since that time (the "Proposal").

NVF's Proposal Was Based Upon the Most Complete and Reliable Information Available

20. In developing its Proposal to the Union, NVF relied upon financial, business and industry information routinely used and maintained in the ordinary course of its business. This information includes, among other things, historical and projected financial performance data, business plans, liquidity and recovery analyses, and other financial information, including the substantial financial information provided by the Debtors in their Schedules of Assets and Liabilities and Statements of Financial Affairs filed with the Bankruptcy Court. Moreover, NVF updated or revised the Proposal as necessary when new or updated information became available.

21. NVF's reliance on such information satisfies its obligation to base its Proposal on the most complete and reliable information available. *See In re Sol-Sieff Produce Co.*, 82 B.R. 787, 793-94 (Bankr. W.D. Pa. 1988) (element satisfied where proposal was based

[9] NVF intends to continue its good faith efforts to reach agreement with the Union's authorized representative in the period before the hearing on this Motion.

on the existing financial information and was amended to include additional statements as they became available); *In re Amherst Sparkle Market, Inc.*, 75 B R. at 850-851 (prerequisite satisfied where proposal was based on the most reliable and complete information available at the time of the proposal where debtor relied on profit and loss reports, balance sheets for the previous fiscal year, cash disbursement data, general ledger and payroll registers, and performance projections).

The Proposed Modifications Are Necessary

22 The Third Circuit has held that the focus of this "necessary" element is "upon the short-term goal of avoiding liquidation, not upon the long-term goal of making debtor 'whole' once it emerges from bankruptcy." *In re Bowen Enters., Inc.*, 196 B.R. at 741-742; *see Wheeling-Pittsburgh Steel Corp. v. USWA*, 791 F 2d 1074, 1088-1089 (3d Cir. 1986); *In re Sol-Sieff Produce Co.*, 82 B.R. at 793; *see also In re Garofalo's Finer Foods*, 117 B.R. at 372-374 Indeed, "[o]nly those modifications which are directly related to debtor's financial condition and are essential to reorganization" are considered necessary *In re Bowen Enters., Inc.*, 196 B.R. at 741-742, *see Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1088-1089 In essence, a proposed modification for purposes of sections 1113 is considered "necessary" where it is the minimum effort required to prevent liquidation. *In re Bowen Enters., Inc.*, 196 B R. at 742, *see In re National Forge Co.*, 289 B R. at 810-811 (finding that the proposals were necessary where debtor lacked the "liquidity to complete a stand-alone reorganization" and required the modifications to effectuate an asset sale to salvage the company), *In re Garofalo's Finer Foods*, 117 B.R at 372 (finding proposals to be "necessary" under *Wheeling-Pittsburgh Steel Corp.* where debtor made all cost reductions possible from other expenses but faced liquidation within weeks absent modification to its labor agreements); *In re Sol-Sieff Produce Co.*, 82 B R. at 792-793 (holding that modification was "essential" where owner could no longer maintain *status quo* through capital investments and faced "reduction or liquidation").

23. Here, if NVF cannot freeze its existing Pension Plan obligations, terminate its Medical Benefits obligations, and modify the Work Rules and certain other obligations, it will be unable to reorganize and emerge as a viable entity. As detailed above, despite NVF's exhaustive efforts to preserve and enhance liquidity and improve its operations – obtaining additional financing, implementing its business plan, selling non-core assets, implementing additional cost-cutting measures – NVF's businesses remain significantly cash flow negative.

24. Through December 2005, NVF will owe approximately $1.5 million in additional minimum contributions in respect of the Pension Plan. Absent a freeze of accrual of current benefits under the Pension Plan, during the year 2006, NVF will be required to make minimum contributions to the Pension Plan in amounts in excess of $4 million. On the other hand, freezing current benefits will save NVF approximately $150,000 per year, beginning in mid-2006. The success of NVF's business plan and reorganization strategy depend upon its ability to achieve these savings.

25. The Proposal as it relates to the Pension Plan is based on a careful analysis of NVF's financial situation and is narrowly designed to avoid liquidation. Specifically, NVF's Proposal provides for the freezing (rather than termination) of the Pension Plan. Additionally, the Proposal does not completely exclude the possibility that at some point in the future NVF may be able to reinstate some or all of the Medical Benefits.

26. NVF, in conjunction with its legal and financial advisors, has considered other ways to reduce its pension funding obligations short of freezing the Pension Plan. For example, NVF has considered seeking funding waivers from the Internal Revenue Service for three successive years. Unfortunately, this alternative does not provide the reduction in pension funding obligations that NVF requires. A waiver application should not be filed until after the

beginning of the year for which the contributions sought to be waived are due, and there can be no assurance that a waiver would be granted Moreover, waivers may only be granted for three of any 15 plan years 29 U.S.C. § 1083(a) In addition, each waived funding deficiency must be amortized over a period of five plan years, with interest at 150% of the federal mid-term rate *Id.* The result is that the Pension Plan funding obligations that are projected for future periods would merely be deferred for a short time period, eliminating any savings to NVF's estate and still leaving the reorganized entity unable to fund the obligations once any short deferral period expires In contrast, NVF estimates that the savings to its estate associated with freezing obligations under the Pension Plan will be approximately $150,000 per year.[10]

27. Accordingly, NVF has determined that freezing the Pension Plan is the best alternative available to avoid liquidation and emerge from bankruptcy Under ERISA, a plan sponsor's only options with respect to pension plans it can no longer support are (a) freezing the plans, (b) seeking a funding waiver or waivers, and (c) terminating the plans As indicated above, the second option does not provide anywhere near the amount of relief necessary to permit a successful reorganization. Moreover, NVF believes that terminating the Pension Plan is unnecessary and unadvisable at this time given the underfunded nature of the Pension Plan and the Other Plans Freezing the existing Pension Plan obligations is the only way to allow NVF to pursue its reorganization plan and emerge as a viable entity

28. In addition to freezing benefits under the Pension Plan, NVF requires termination of the Medical Benefits in order to avoid immediate liquidation NVF has carefully analyzed its ability to fund its Medical Benefits obligations under the CBA on a going forward basis and has determined that such funding is impossible in light of NVF's expected future cash

[10] NVF currently is engaged in discussions with the Union regarding, among other things, the terms of the Proposal Accordingly, as a result of such discussions, this amount could change.

flow In an effort to mitigate the harm that may be caused to Union Employees as a result of the termination of the Medical Benefits, as part of its Proposal NVF has offered each Union Employee otherwise entitled to Medical Benefits a $500 per month stipend (collectively, the "Stipend") to be used towards purchase of personal medical insurance or payment of medical bills, in the Union Employee's discretion In contrast to the approximately $36,000 per month in anticipated costs were NVF required to fund the Medical Benefits on the terms provided in the CBA, the total Stipend cost to NVF will be approximately $6,500 per month, creating critical savings of approximately $29,500 per month Absent this savings, NVF will not be able to successfully reorganize into a viable going concern

29 Similarly, NVF requires modification of the Work Rules under the CBA in order to successfully implement its reorganization strategy The current Work Rules make it impossible for NVF to operate in a cost-efficient manner, which is critical to the success of NVF's reorganization The modifications to the Work Rules proposed by NVF restore management's ability to tailor NVF's work force to satisfy customer needs while still providing a full week's work to the Union Employees Absent NVF's ability to maximize the efficiency of its workforce by hiring and utilizing employees with multiple skill sets, NVF will be unable to emerge from chapter 11 as a viable, profitable entity and will have no option but to liquidate its remaining assets either in these chapter 11 cases or through conversion to chapter 7.

30 NVF's proposal is aimed at providing a fair and equitable recovery for all constituencies, and ensuring that the emerging entity will have adequate cash flow and a qualified, affordable work force For all these reasons, the proposed modifications are necessary within the meaning of section 1113 of the Bankruptcy Code *See Ionosphere Clubs*, 134 B.R at 525.

The Proposed Modifications Assure That All Creditors,
<u>the Debtors and All Affected Parties Are Treated Fairly and Equitably</u>

31 Section 1113 prevents a debtor from saddling retirees with "a disproportionate share of the financial burden of avoiding liquidation." *In re National Forge Co.*, 289 B.R. at 911 (addressing a section 1113 motion), *In re Bowen Enters., Inc.*, 196 B.R. at 743; *see Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1091 The burden must be shared fairly and equitably among all parties, rather than imposed exclusively on bargaining unit employees or retirees. *In re National Forge Co.*, 289 B.R. at 911; *In re Bowen Enters., Inc.*, 196 B.R. at 743, *see Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1091

32. NVF's Proposal is designed to assure equitable treatment for all constituencies involved in this proceeding Indeed, it does not result in a disproportionate burden on any constituency Through NVF's Proposal and other cost-saving measures , all constituencies – hourly and salaried employees alike - are asked to make similar sacrifices to accomplish the Debtors' reorganization

NVF Provided All Relevant
<u>Information Necessary to Evaluate the Proposal</u>

33 Courts have found that providing the company's current financial information is sufficient to meet the above requirement, unless the authorized representative has shown a need for specific information beyond the current financial data *In re Allied Delivery System*, 49 B.R. 700, 703 (Bankr. N.D. Ohio 1985) ("This Court finds that in the absence of the union's showing of a need for specific information beyond the current financial information provided by the debtor, the debtor has complied."); *see also In re National Forge Co.*, 289 B.R. at 812 (debtor complied with requirement by (1) providing union with asset purchase agreement, sale motion, liquidation plan, disclosure statement, and information on potential buyers, (2) responding to all the union's requests; and (3) arranging for its financial advisor to walk through

liquidation process with union); *In re Bowen Enters., Inc.*, 196 B.R. at 739-741 (debtor satisfied this element by (1) providing union with financial statements, federal income tax returns, a cost analysis, and other requested information; and (2) by arranging for its accountant to attend bargaining sessions to answer the union's questions regarding the cost analysis and savings projections); *In re Sol-Sieff Produce Co.*, 82 B.R. at 794 (finding this requirement satisfied where debtor accommodated all union requests, instructed its accountant to make financial data available, and delivered financial statements as soon as completed)

34 NVF clearly has complied with its obligation to provide the Union with all relevant information to evaluate the Proposal. Both before and after giving the Union the Proposal, NVF provided the Union and its advisors with information pertaining to NVF's financial situation and to the Proposal. Moreover, the Union has access to all information made available to the public through these chapter 11 cases

35 NVF provided this information voluntarily in face-to-face meetings and remains willing and able to respond to any further requests by the Union's representative [11] Specifically, NVF initially met with the Union on April 1, 2005, and held continued meetings on at least eight separate occasions in an effort to give the Union an understanding of the context of the bankruptcy, NVF's financial situation, NVF's efforts to restructure its business, and the significant barriers to restructuring presented by the Pension Plan obligations, Medical Benefit obligations and Work Rules. Under these circumstances, NVF clearly has provided all relevant information necessary to evaluate its Proposal

[11] As of the date of this Motion, the Union has not submitted any formal information requests. Moreover, the Union has not indicated in writing that it has any specific questions concerning the Proposal.

NVF Has Met and Been Available
<u>to Meet with the Union at all Reasonable Times</u>

36 NVF has satisfied this requirement by meeting with the Union numerous times since initially submitting the Proposal *See In re National Forge Co.*, 289 B.R. at 812 (debtor satisfied this requirement where it or its financial advisor met with union five times over a matter of weeks, including the day of the hearing), *In re Bowen Enters., Inc.*, 196 B.R. at 739-741 (element satisfied where debtor held six bargaining sessions with the union in less than three months); *In re Amherst Sparkle Market, Inc.*, 75 B.R. at 852 (two meetings with the union to discuss the proposal was deemed reasonable). NVF has met regularly with the Union as set forth herein NVF has never refused to meet with the Union to discuss proposals or counterproposals and remains ready and willing to meet with the Union pending a hearing on this Motion.

<u>NVF Has Conferred with the Union in Good Faith</u>

37. The "good faith" effort element requires "conduct indicating an honest purpose to arrive at an agreement as the result of the bargaining process." *In re Bowen Enters., Inc.*, 196 B.R. at 744 (quoting *Matter of Walway Co.*, 69 B.R. 967, 973 (Bankr. E.D. Mich. 1987)). A debtor satisfies this element by engaging in serious negotiations regarding reasonable modifications prior to the associated motion. *In re Bowen Enters., Inc.*, 196 B.R. at 744. A debtor has conferred in good faith so long as it has remained "ready, willing, and able to negotiate modifications." *Id.* at 744-745 (holding that the debtor bargained in good faith where it consistently delivered information to the union regarding the proposals, arranged for its accountant to attend negotiations, responded to the union's counterproposal, and withdrew non-economic proposals); *In re National Forge Co.*, 289 B.R. at 812 (debtor conferred in good faith where union refused to negotiate, steadfastly reiterating harsh demands outside the debtor's control)

38 NVF has conferred in good faith with the Union because NVF has "seriously attempted to negotiate reasonable modifications" to the CBA prior to any hearing regarding the rejection of the CBA pursuant to section 1113 of the Bankruptcy Code. *See In re Kentucky Truck Sales, Inc.*, 52 B.R 797, 801 (Bankr. W.D. Ky. 1985) (defining good faith). NVF's Proposal has been limited to the relief absolutely necessary to ensure the successful reorganization of NVF's operations. Further, NVF's good faith is demonstrated by its efforts to involve the Union early in the restructuring process (indeed, many of the meetings with the Union were held prior to the Petition Date); by NVF's overall willingness to discuss various concessions, proposals and counter proposals; and by NVF's availability to meet regularly with the Union. *In re Bowen Enters., Inc.*, 196 B.R at 744, *see In re Salt Creek Freightways*, 47 B.R 835, 839-841 (Bankr. D. Wyo. 1985) (rejection of collective bargaining agreement granted where debtor conducted negotiations in good faith by meeting with the Union on four occasions, providing the union with information, offering alternatives, considering counter proposals, and providing the union with a last best offer)

The Union Rejected the Proposed Modifications Without Good Cause

39. NVF brings this Motion because the Union has failed to accept the Proposal without good cause. The Union is aware of the difficult financial situation in which NVF finds itself. The Union is also fully aware that the reorganized entity, no matter how configured, could not possibly support the ongoing funding obligations of the Pension Plan, let alone make payment of the Medical Benefits and operate under the burdensome Work Rules. NVF has been conferring with the Union for months, has provided supporting financial information, and has met with the Union to negotiate the terms of a workable solution. To date, the Union has not provided any counter proposal that fully address the economic realities of NVF's financial situation. Simply put, it has failed to accept the proposed modifications without

good cause *See e.g., In re Bowen Enters., Inc.*, 196 B.R. at 746; *In re Royal Composing Room, Inc.*, 848 F 2d at 347 Because the Union has unreasonably refused to consent to a freezing of the Pension Plan, termination of the Medical Benefits and modification of the Work Rules, NVF has no alternative but to seek to reject the CBA in its entirety in order to preserve any opportunity for reorganization

<u>The Balance of the Equities Clearly Favors Rejection of the CBA</u>

40 The balance of the equities clearly favors the rejection of the CBA because NVF needs substantial relief from its Pension Benefit obligations, Medical Benefit obligations and Work Rules and has bargained in good faith in an attempt to reach an agreement with the Union Without substantial relief from these obligations, NVF simply cannot successfully reorganize NVF bargained in good faith with the Union in an attempt to reach an agreement that provides the necessary relief. The on-going negotiations with the Union and the fact that NVF has given the Union full access to the relevant information, are both evidence of "conduct indicating an honest purpose to arrive at an agreement as the result of the bargaining process." *Matter of Walway*, 69 B R. at 973.

41. On the other hand, the Union has failed to tender any written counter proposal, let alone a proposal that meets NVF's needs, and has not accepted NVF's Proposal for necessary modifications Under such circumstances, the balance of the equities clearly favors rejection of the CBA *In re Royal Composing Room, Inc.*, 848 F 2d at 349 ("[T]he balance of the equities nearly always will tip in favor of the party that seeks to reach a compromise and to that end negotiates in good faith.").

42. Further, rejection of the Proposal means that NVF will be unable to reorganize and emerge from chapter 11 as a viable entity if the Court does not authorize the modifications requested herein. The prospect of a liquidation tips the balance of the equities in

favor the rejection of the CBA. *See In re Bowen Enters., Inc.*, 196 B.R. at 747 (finding that the balance favored modification where debtor would unquestionably face liquidation unless relieved of its high labor costs); *see In re National Forge Co.*, 289 B.R. at 813 (balance demanded rejection where asset sale hinged on modification of collective bargaining agreement and where it was needed to stave off liquidation and achieve the best sale price for all interested parties); *In re Sol-Sieff Produce Co.*, 82 B.R. at 795 (noting that the balance of the equities favored rejection where liquidation was otherwise "a certainty").

Notice

43. No trustee or examiner has been appointed in the Debtors' chapter 11 cases. Notice of this Motion has been provided to (i) the Office of the United States Trustee for the District of Delaware, (ii) counsel for the Debtors' postpetition lender, (iii) the Union's representative, (iv) counsel to the Committee and (v) those parties who have requested notice pursuant to Bankruptcy Rule 2002(g). In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required.

44. No previous motion for the relief sought herein has been made to this or any other court.

45. The Debtors submit that this Motion does not present any novel issues of law requiring briefing. Therefore, pursuant to Rule 7.1.2 of the Local Rules of Civil Practice and Procedure of the United States District Court for the District of Delaware (the "Local District Court Rule"), incorporated by reference into Local Rule 1001-1(b), the Debtors respectfully request that the Court set aside the briefing schedule set forth in Rule 7.1.2(a) of the Local District Court Rules.

WHEREFORE, NVF respectfully requests that the Court enter an order, substantially in the form attached hereto as Exhibit 1, authorizing the rejection of the CBA and granting such other and further relief as the Court deems just and proper.

Dated: September 8, 2005
Wilmington, Delaware

Rebecca L. Booth

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ATTORNEYS FOR DEBTORS AND
DEBTORS IN POSSESSION

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
NVF COMPANY, et al.,	)	Case No. 05-11727 (PJW)
	)	
Debtors.	)	Jointly Administered
	)	
	)	**Objection Deadline: September 23, 2005,**
	)	**4:00 p.m. (Extended)**
	)	**Hearing Date: September 28, 2005 at 2:30 p.m.**

OBJECTION OF UNITED STEELWORKERS TO AND MOTION TO DISMISS THE MOTION OF DEBTOR AND DEBTOR IN POSSESSION FOR AN ORDER AUTHORIZING THE REJECTION OF A COLLECTIVE BARGAINING AGREEMENT PURSUANT TO SECTION 1113 OF THE BANKRUPTCY CODE (Docket No. 135)

1. Introduction.

The United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union ("USW" or "United Steelworkers") files this objection and motion to dismiss in connection with the above referenced application ("Section 1113 Motion") filed by the Debtor NVF Company ("Company") pursuant to Section 1113.[1] The USW files this objection and motion to dismiss to address a single, critical threshold issue – whether as a matter of law this Court may enter relief pursuant to Section 1113 of the Code to reject a collective bargaining agreement that has already expired.

Counsel for the parties have discussed the treatment of the Section 1113 Motion and the USW's objection and have generally agreed to utilize the September 28, 2005 hearing in order for this Court to consider oral argument on the USW's objection and

[1] The Company's bargaining unit employees had been represented by Local Union 770 of the Paper, Allied-Industrial, Chemical and Energy International Union ("PACE").

motion to dismiss. The parties have also generally agreed that if this Court denies the USW's objection and motion to dismiss, the parties would ask this Court to establish a schedule for filing briefs and commencing a hearing upon the merits of the Section 1113 Motion. If this Court were to grant the United Steelworkers' objection and motion to dismiss on this threshold issue, there would be no need for the parties to prepare for a lengthy hearing on the Section 1113 Motion or for this Court to set aside significant time to consider the matter. In the event that this Court denies the USW's objection and motion to dismiss, the USW preserves any and all defenses that it may have to the Section 1113 Motion.

The United Steelworkers and its predecessor's unions have served for many years as the bargaining agent of the hourly employees at numerous of the Company's facilities and the parties have been subject to numerous collective bargaining agreements. The most recent collective bargaining agreement expired on April 28, 2005. The parties did not negotiate a successor collective bargaining agreement, nor did they agree to an extension of the agreement. Rather, since late April, the Company has been operating pursuant to the existing terms and conditions of employment, which is its obligation under federal labor law.

In its Section 1113 Motion, the Company ignores this inconvenient and determinative fact, which ultimately is fatal to its application for relief.

In April 2005, PACE merged with the United Steelworkers of America, AFL-CIO·CLC and the merged labor organization is known as the United Steelworkers or USW.

2. A Debtor In Possession May Not Utilize Section 1113 To Reject Its Statutory Obligations Under Labor Law Following The Expiration Of A Collective Bargaining Agreement.

A bankruptcy court, acting pursuant to Section 1113, may not authorize the rejection of an expired collective bargaining agreement. The court in In re Charles P. Young Company, 111 B.R. 410 (Bankr. S.D. N.Y. 1990), succinctly stated: "Rejection of a collective bargaining agreement pursuant to § 1113(b) and (c) is a moot issue if the agreement expires by its own terms and before the bankruptcy court has a hearing on rejection." 111 B.R. at 413. Accord In re Sullivan Motor Delivery Co., 56 B.R. 28, 30 (Bankr. E.D. Wisc. 1985) (refusing to authorize the rejection of a collective bargaining agreement that had expired prepetition); see In re San Rafael Baking Co., 219 B.R. 860, 865-66 (9th Cir. BAP 1998) (finding that relief under Section 1113(f) is not available with respect to an expired labor agreement); In re D&O Coal Co., 93 B.R. 454, 455-56 (Bankr. W.D. Va. 1988) (distinguishing a situation in which a court had authorized interim relief prior to contract expiration); see also 7 Collier on Bankruptcy, ¶ 1113.02[1] (15th ed. Rev. 2004) (explaining that "[Section 1113] does not apply to expired collective bargaining agreements"); In re Roth American, Inc., 975 F.2d 949, 956 (3d Cir. 1992) (stating that "in enacting Section 1113, Congress intended to preclude employers from using bankruptcy law as an offensive weapon in labor relations by going into bankruptcy and unilaterally rejecting or modifying the extant collective bargaining agreement") (emphasis added). As the Ninth Circuit pointedly noted, "an unexpired collective bargaining agreement is an executory contract susceptible of assumption or rejection by the debtor." See Wien Air Alaska, Inc. v. Bachner, 865 F.2d 1106, 1111 (9th Cir. 1989) (emphasis added).[2]

Prior to the enactment of Section 1113, courts likewise held that a debtor could not reject an expired collective bargaining agreement under Bankruptcy Code Section 365. Gloria Mfg. Corp. v. Int'l Ladies Garment Wkrs. Union, 734 F.2d 1020, 1022 (4th Cir. 1984) (holding that "[o]nce a contract has expired on its own terms, there is nothing left for the trustee to reject or assume"). In In re Pesce Baking Company, Incorporated, 43 B.R. 949 (Bankr. N.D. Ohio 1984), the court explained:

> "[T]he debtor's collective bargaining agreement with the Machinists expired of its own terms before this court could hold a hearing on debtor's application. Thus, at the present time, the debtor's collective bargaining agreement with the Machinists is not an executory contract. It has expired and there can be no performance by either party under the terms of the agreement.
>
> The critical date for determining the executory nature of a contract is the date on which the bankruptcy court considers the debtor's application. . . . Although a collective bargaining agreement may be executory on the date a debtor's bankruptcy petition is filed, once the

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2 But see In re Ormet Corp., 316 B.R. 662, (Bankr. S.D. Ohio 2004) (finding that "[u]nder the unique facts presented by [the] case," a debtor could obtain the rejection of two collective bargaining agreements that had expired before the filing of its Section 1113 motion). According to the Ormet court, which failed to cite a single case in concluding that it could authorize relief, the "unique facts" included "the complexities of the debtors' economic model[,] . . . the severe time constraints placed on the parties" in connection with the debtors' plan confirmation process, and its conclusion that "[n]one of the cases cited by the parties in their briefs is controlling authority" within the Southern District of Ohio. The USW, the bargaining agent of the Ormet employees, filed a timely appeal of the matter to the District Court, where the matter remains. Even if Ormet was correctly decided, none of the "unique facts" in that matter are relevant here. By contrast, the bankruptcy court in Sullivan Motors observed that "[e]very case which this court has considered on the subject of § 1113 and where the court approved the rejection of the particular collective bargaining agreement involved unexpired collective bargaining agreements." 56 B.R. at 30.

agreement expires of its own terms, the debtor's application to reject it becomes moot."

Id. at 957 (emphasis added) (citations omitted).

Principles adopted under Section 365 that are not inconsistent with Section 1113 continue to apply. As the Fourth Circuit has emphasized, "[S]ection 365 continues to apply to collective bargaining agreements, except where such an application would create an irreconcilable conflict with § 1113. . . . Section 1113 is designed to provide additional procedural requirements for rejection or modification of collective bargaining agreements, and only to that degree supersedes and supplants the provisions of § 365." Adventure Resources, Inc. v. Holland, 137 F.3d 786, 798 (4th Cir. 1998) (internal quotation and citation omitted). See also In re Certified Air Technologies, Inc., 300 B.R. 355, 366 (Bankr. C.D. Cal. 2003) (explaining that "Section 1113 was enacted to override Bildisco[3] and set more rigorous standards for the rejection of collective bargaining agreement than for other executory contracts or leases") (emphasis added). In sum, Section 1113 specifies additional restrictions on the right to reject labor agreements as interpreted under Section 365, but Section 365 applies to executory collective bargaining agreements in other respects.

Where, as here, a collective bargaining agreement has expired, it is an employer's statutory obligation under federal labor law, and not a contractual obligation, that obligates an employer to maintain existing terms and conditions of employment absent the finding of a good faith impasse. 29 U.S.C. §§ 158(a)(5) and 158(d); NLRB v. Katz, 369 U.S. 736, 743 (1962) (holding that "an employer's unilateral change in terms and conditions of employment under negotiation is similarly a violation of § 8(a)(5), for it is a

[3] NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984).

circumvention of the duty to negotiate which frustrates the objectives of § 8(a)(5) as much as a flat refusal"). The Supreme Court later made clear in Litton Financial Printing Division v. NLRB, 501 U.S. 190 (1991), which followed and reviewed Katz, that it is only the statutory obligation, and not the contract, that exists after contract expiration. The Litton Court noted that this conclusion was made clear by the situation in Katz, where a first contract had not yet been reached:

> "Although after expiration most terms and conditions of employment are not subject to change, in order to protect the statutory right to bargain, those terms and conditions no longer have force by virtue of contract. . . . Under Katz, terms and conditions continue in effect by operation of the NLRA. . . . As the union acknowledges, the obligation not to make unilateral changes is rooted not in the contract but in the preservation of existing terms and conditions of employment and applies before any contract has been negotiated. . . . Katz illustrates this point with utter clarity, for in Katz the employer was barred from imposing unilateral changes even though the parties had yet to execute their first collective bargaining agreement."

Litton, 501 U.S. at 206-07 (emphasis added). The Litton Court likewise explained that "[a]n expired collective bargaining agreement is no longer a legally enforceable document." Id. at 206 (internal quotation and citation omitted).

There is nothing in the text, legislative history, or case law interpreting Section 1113 that in any way suggests that the statute extends beyond collective bargaining agreements and authorizes "rejection" of statutory obligations. Indeed, Section 1113 only speaks in terms of collective bargaining agreements, providing that "[t]he debtor in possession . . . may assume or reject a collective bargaining agreement only in accordance with this section." 11 U.S.C. § 1113(a). As the Supreme Court explained in Litton, an employer's obligations following the expiration of a collective bargaining agreement are statutory, and not contractual, in nature, and, as such, a debtor cannot obtain relief pursuant to Section 1113 to reject an expired collective bargaining agreement.

3. The Company's Section 1113 Motion Must Be Dismissed Because Its Collective Bargaining Agreement With The United Steelworkers Expired Nearly Five Months Ago.

On the basis of the overwhelming authority under both the Bankruptcy Code and federal labor law, the Section 1113 Motion, which seeks to reject a collective bargaining agreement that expired on April 28, 2005, must be dismissed. The Company has not fashioned a basis for obtaining the rejection of this long-ago expired labor agreement, nor could it fashion such a theory.

The Company and the United Steelworkers continue to discuss a collectively bargained resolution to this dispute. Indeed, on the afternoon of Friday, September 23, 2005, the members of the USW Local Union will conduct a membership meeting to vote upon the Company's most recent offer. The United Steelworkers is hopeful that its members will ratify the Company's proposal and, in all events, the USW remains committed to pursuing a consensual resolution. Nevertheless, the United Steelworkers cannot permit the Company to use the club of Section 1113 to alter its terms and conditions of employment when there is no statutory basis for doing so. Consequently, the Section 1113 Motion must be dismissed as a matter of law.

Respectfully submitted,

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- and –

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Counsel for United Steelworkers

Dated: September 23, 2005

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re	Chapter 11
FLYi, Inc., *et al.*,[1]	Case No. 05-20011 (MFW)
Debtors.	(Jointly Administered)
	Hearing Date: January 5, 2006 at 10:00 a.m. (ET)
	Objection Deadline: January 4, 2006 at 5:00 p.m. (ET)

EMERGENCY MOTION OF THE DEBTORS FOR AN ORDER (I) AUTHORIZING THEM TO DISCONTINUE THEIR SCHEDULED FLIGHT OPERATIONS AND TAKE CERTAIN ACTIONS IN CONNECTION THEREWITH; (II) APPROVING A WIND-DOWN EMPLOYEE PLAN; (III) APPROVING THE PAYMENT OF CERTAIN SEVERANCE, VACATION AND OTHER BENEFITS AND AMOUNTS TO TERMINATED OR FURLOUGHED EMPLOYEES; AND (IV) TO THE EXTENT NECESSARY, AUTHORIZING THE MODIFICATION OF COLLECTIVE BARGAINING AGREEMENTS PURSUANT TO SECTION 1113(e) OF THE BANKRUPTCY CODE IN CONNECTION THEREWITH

The above-captioned debtors (collectively, the "Debtors") hereby move the Court for the entry of an order pursuant to sections 105(a), 363 and 1113(e) of title 11, United States Code (the "Bankruptcy Code"): (i) authorizing them to discontinue their scheduled flight operations and take certain actions in connection therewith; (ii) approving a wind-down employee plan; (iii) approving the payment of certain severance, vacation and other benefits and amounts to terminated or furloughed employees; and (iv) to the extent necessary, authorizing

[1] The Debtors are the following seven entities (the last four digits of their respective taxpayer identification numbers, if any, follow in parentheses): FLYi, Inc. (1051); Independence Air, Inc. (1749); Atlantic Coast Jet, LLC (1492); Atlantic Coast Academy, Inc. (9852); IA Sub, Inc. (none); WaKeeney, Inc. (none); and Atlantic Coast Airlines, Inc. (none). The address of each of the Debtors is 45200 Business Court, Dulles, VA 20166.

the modification of collective bargaining agreements in connection therewith. In support of this Motion (the "Wind-Down Motion"), the Debtors respectfully represent as follows:

Preliminary Statement

1. Today truly is a sad day for all parties in interest, including the thousands of dedicated employees who have dedicated tremendous time and effort to creating and operating the Debtors' premier airline operations. After 12 years as a successful regional carrier and 18 months of independent operations, the Debtors have made the difficult decision that they must seek to discontinue their scheduled flight operations in order to maximize the value of their estates for their creditors. Despite the hard work of all the people involved in the Debtors' operations, the Debtors were unable to secure an investment by or sale to a third party that would provide sufficient value to allow for the continued operation of the Debtors' airline.

2. Accordingly, by this Wind-Down Motion, the Debtors seek authority to discontinue their scheduled flight operations and pay certain termination benefits to employees terminated or furloughed as a result, as well as compensate the employees that will remain with the Debtors to assist in the winding down of the Debtors' affairs. Although the Debtors have the authority to make some of these payments and take some of these actions without court authority, the Debtors are presenting all of the information herein to give a complete presentation of the events to take place. The Debtors also will be filing certain other motions contemporaneously with this Wind-Down Motion or in the coming days seeking additional relief related to the discontinuation of operations.

Background

3. On November 7, 2005 (the "Commencement Date"), each of the Debtors commenced a case under chapter 11 of the Bankruptcy Code.[2] FLYi, Inc. ("FLYi"), through its operating subsidiary Independence Air, Inc. ("Independence"), operates a premier low-cost, low-fare airline providing all-jet service to various destinations throughout the United States.

Events Leading to the Need to Discontinue the Debtors' Scheduled Flight Operations

The Commencement of the Debtors' Chapter 11 Cases and the Sale Process

4. As more fully described in the Affidavit of Steven Westberg in Support of First Day Motions (D.I. 4) filed on the Commencement Date (the "First Day Affidavit"), the Debtors operated as a regional air carrier for certain major airlines since its inception in 1992. In June 2004, the Debtors commenced independent airline operations as "Independence Air." During the year and a half since their commencement of independent operations, the Debtors have taken significant steps to attempt to improve revenues, reduce costs and increase liquidity. Since July 2005, the Debtors and their financial advisors have been engaged in the process of revising their business plan and searching for sources of new capital to enable the Debtors to continue as a going concern. However, the deteriorating conditions in the airline industry over the last 18 months have severely affected the Debtors and impaired their ability to obtain the necessary additional capital and successfully implement a revised business plan.

5. As a result of the Debtors' continued operating losses, the Debtors commenced these chapter 11 cases to conserve their cash and to use the chapter 11 process to

[2] This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue for this matter is proper in this district pursuant to 28 U.S.C. § 1409.

continue their efforts to find an investor, strategic partner or purchaser. To further that process, the Debtors sought, and on November 22, 2005 obtained, Court approval of procedures to solicit bids for an investment or sale proposal relating to the Debtors' business and assets (the "Bidding Procedures"). See Order (I) Approving (A) Procedures for the Consideration of Investment or Sale Proposals and (B) the Form and Manner of Notice Thereof and (II) Scheduling an Auction and Hearing to Approve a Definitive Agreement (D.I. 194). Pursuant to the Bidding Procedures: (a) initial expressions of interests were due on December 1, 2005; (b) formal bids were due on December 16, 2005; (c) an auction was originally scheduled for January 3, 2006; and (d) a hearing to approve an investment or sale proposal was originally scheduled for January 5, 2006.

6. As contemplated by the Bidding Procedures, the Debtors and their professionals have been working diligently to find an investor or purchaser for the Debtors' business. The Debtors received multiple expressions of interest for the Debtors' business and assets by the December 1 deadline for such expressions. Since the beginning of December, the Debtors, in consultation at all times with the Official Committee of Unsecured Creditors appointed in these chapter 11 cases (the "Committee"), have been focused on developing the going concern expressions of interest. Although the Debtors received several formal bids by the December 16, 2005 bid deadline, only one formal bid contemplated the continuation of the Debtors' operations as a going concern (the "Going Concern Bid"). The Going Concern Bid, however, had several features that prevented the Debtors from accepting it as a viable bid for the Debtors' business. For example, the Going Concern Bid provided insufficient consideration, had numerous conditions that were beyond the Debtors' control to satisfy (such as the renegotiation of certain material contracts on terms acceptable to the bidder) and did not

provide for funding (without recourse to the Debtors' estates) for the significant operating losses and cash burn the Debtors expected to incur prior to closing of the transaction (even assuming that the conditions could be satisfied).

7. Since receiving the Going Concern Bid, the Debtors have been focused, in consultation with the Committee, on developing and improving that bid, as well as continuing discussions with bidders that had expressed interest in a going concern transaction in the past. Ultimately, however, the Debtors were unable to substantially improve the Going Concern Bid or find an attractive alternative going concern bidder.

8. After intensive evaluation of all of their alternatives, the Debtors concluded that the value of their estates would be maximized by discontinuation of their scheduled flight operations and liquidation of their assets pursuant to one or more sale or other transactions that do not contemplate the continued operation of Independence Air as a going concern. The Debtors made that determination after discussions with the Committee regarding all of their alternatives, including the multiple indications of interest received, and after evaluating the economic terms of the Going Concern Bid, as well as the costs and risks associated with implementing such bid.

The Debtors' Current Financial Position

9. As described in the First Day Affidavit, the Debtors' principal operating assets consist of their operating fleet of 12 Airbus A319 aircraft (the "A319s") and 30 Bombardier CRJ-200 regional jets the ("CRJs")[3] and the spare parts, equipment, airport

[3] During these chapter 11 cases, the Debtors sought to reject leases for, or abandon, 28 of the 58 CRJs they owned or leased as of the Commencement Date. By order entered December 5, 2005, the Court approved the rejection or abandonment of 22 CRJs. Orders approving the rejection of an additional six CRJs have been filed under certifications of counsel dated December 29, 2005 and December 30, 2005 (D.I. 392, 407).

landing slots, terminal facilities, hangar, airline operating certificate and other assets used in connection with the airline operations. The Company's primary non-operating assets consist of (a) unrestricted cash, (b) restricted cash and (c) certain claims against United Airlines, Inc. ("United").

Liquidity

10. As of the Commencement Date, the Debtors had approximately (a) $24.0 million in unrestricted and unencumbered cash and (b) $46.8 million in restricted cash. As of December 30, 2005, after approximately seven weeks of operations in chapter 11, the Debtors had approximately (a) $29.3 million in unrestricted and unencumbered cash and (b) $30.8 million in restricted cash. The Debtors also have accrued and unpaid postpetition administrative expenses, including aircraft rent, professional fees, wages, fuel and other operating costs, of approximately $27 million as of December 30, 2005.

11. Absent the implementation of a debtor in possession financing facility, if the Debtors do not immediately discontinue scheduled flight operations, the Debtors believe that they will run out of unrestricted and unencumbered cash during the month of January 2006, assuming that they would have to pay all amounts owing to their aircraft lenders and lessors for the continued use of the 12 A319s and 30 CRJs in their current operating fleet that accrued and will continue to accrue during the first 60 days of these cases. The Debtors have also determined that, given the nature of the final bids received in the bidding process and the need to maximize the value of their estates, it is not advisable to seek to implement a debtor in possession financing facility that would otherwise permit them to continue operations and the pursuit of a going concern transaction. If the Debtors discontinue operations immediately, they expect to have sufficient cash resources to implement an orderly discontinuation of scheduled flight operations and the liquidation of their estates, including payment of the amounts

requested to be paid pursuant to this Wind-Down Motion. In addition, as described below, the Debtors believe that, if they discontinue scheduled flight operations immediately, the proceeds of the liquidation of their assets, including the United Claim (as such term is defined below) if upheld on appeal, will result in distributions to general unsecured creditors in these chapter 11 cases.

The United Claim

12. One major development since the Commencement Date is the allowance of the Debtors' claim against United in United's chapter 11 case, pending in the United States Bankruptcy Court for the Northern District of Illinois (the "Illinois Bankruptcy Court"), for damages arising from United's rejection of the agreements between the Debtors and United under which the Debtors served as a regional airline as part of the United Express program (the "United Rejection Claim"). By order entered on December 15, 2005, the Illinois Bankruptcy Court allowed the United Rejection Claim in the amount of $500 million. The Debtors, United and the creditors' committee that was appointed in United's chapter 11 case have all filed notices of appeal of that order. Based on the current trading value of general unsecured claims in the United chapter 11 case, the Debtors estimate that the United Rejection Claim would ultimately provide over $80 million in value to the Debtors' estates if the allowed amount remains unchanged after the appeal.[4] The United Rejection Claim is an unencumbered asset of the estates.

[4] The Debtors also are investigating potential claims against United for certain violations of federal antitrust laws.

The Process of Discontinuing the Debtors' Scheduled Flight Operations

13. Given the outcome of the Debtors' auction process as well as their liquidity constraints and expected cash burn, the Debtors have determined not to further pursue a going concern bid. Instead, the Debtors believe that the proper course of action at this time is to immediately discontinue their scheduled flight operations and to liquidate their individual assets in a manner that maximizes the value of such assets. The process for discontinuing the Debtors' flight operations and for liquidating the Debtors' assets is described below.

Operations

14. The Debtors have developed a plan to discontinue their scheduled flight operations in as orderly a manner as possible. Pursuant to that discontinuation plan, the Debtors issued a press release on the same day as the filing of this Wind-Down Motion announcing their intention to discontinue operations on the evening of January 5, 2006. On that date, the Debtors' last flights are scheduled to depart from Dulles International Airport ("Dulles") by approximately 6:00 p.m. and will depart all other destinations by approximately 8:00 p.m. All of the Debtors' aircraft will be returned to Dulles, where the aircraft will be prepared for return to the appropriate lessors and secured parties. The Debtors also will take steps to secure their facilities and the assets therein. Finally, subject to approval by this Court, the Debtors intend promptly to issue refunds to customers booked on flights scheduled to depart after the time of discontinuation of the Debtors' scheduled flight operations, whether the applicable tickets were purchased pre- or postpetition, for the reasons described below (the "Customer Refunds").

Aircraft Lease Rejections

15. As indicated above, among the Debtors' remaining key operating assets are 12 A319 and 30 CRJ aircraft in their operating fleet (the "Remaining Aircraft"). Pursuant to a separate motion (the "Wind-Down Rejection Motion") filed contemporaneously herewith, the

Debtors will seek to reject the leases for all of the leased aircraft and to abandon their owned aircraft. In order to make the return of the Remaining Aircraft as smooth and expeditious as possible, the Debtors will request the entry of an order rejecting the leases on the Remaining Aircraft on terms substantially similar to those entered earlier in these cases for the rejection of CRJ aircraft. Given that the issues relevant to the Wind-Down Rejection Motion have been litigated and negotiated already in these cases and that the aircraft will no longer provide any value to the Debtors' estates beginning on January 6, 2006, the Debtors will be seeking the entry of the rejection order on an expedited basis on January 5, 2006.

Liquidation of the Debtors' Assets/Postponement of the Auction Date

16. Following the discontinuation of scheduled flight operations, the Debtors will focus their attention on liquidating their individual assets in an orderly fashion and minimizing the claims asserted against the Debtors' estates. In connection with that effort, the Debtors are hereby advising all interested bidders that they are amending their Bidding Procedures. The Debtors will not proceed at this time with the January 3 auction contemplated by the Bidding Procedures. Instead, the Debtors, in consultation with the Committee, will determine the appropriate manner for selling or otherwise disposing of their assets, which may include rescheduling the auction. The Debtors have continued and will continue discussions with bidders that have expressed interest in various components of the Debtors' business. In addition, the Debtors may, by separate application, seek to retain one or more firms to assist in devising an auction process that maximizes the value of certain assets in a post-discontinuation of operations environment.

Employees

Wind-Down Employees

17. Of vital importance to the success of the Debtors' wind-down plan are the individuals who will remain in the Debtors' employ to implement the wind-down process. These employees will be the persons doing the day-to-day work of liquidating the assets, reviewing and resolving the proofs of claim and preparing the appropriate records and reports for the Court and the Debtors' constituencies. Without the institutional knowledge and experience that these employees possess, the wind-down process would be chaotic and much value would be lost to the detriment of these estates. Accordingly, the Debtors are seeking in this Wind-Down Motion the approval of a plan (the "Wind-Down Employee Plan") for the compensation of employees that will remain with the Debtors after the discontinuation of scheduled flight operations to assist in the wind-down of the Debtors' affairs.

Terminated and Furloughed Employees

18. As a result of the discontinuation of the Debtors' operations, the Debtors will be terminating or furloughing approximately 2,520 employees, 1,300 of whom are represented for collective bargaining purposes by unions (the "Union Employees") and 1,220 of whom are not represented by unions (the "Non-Union Employees"). The Debtors are requesting that they be authorized to pay: (a) unpaid wages, salaries or commissions, as well as sick leave used prior to the termination of employment, vacation and severance (collectively, "Compensation"); (b) unreimbursed business expenses (collectively, "Business Expenses") and (c) contributions to, and benefits under, employment benefit plans (collectively, the "Existing Benefits"), in each case, only to the extent that such employees are entitled by established policy or collective bargaining agreement to such amounts, and only to the extent that such amounts accrued postpetition, as well as amounts for such items that accrued prepetition up to

the statutory caps for the Compensation, Business Expenses and Existing Benefits set forth in sections 507(a)(4) and 507(a)(5) of the Bankruptcy Code (after taking into account priority prepetition amounts already paid to such employees during these cases). In addition, the Debtors request authority to continue to provide medical benefits to terminated or furloughed employees for 60 days after the discontinuation of operations to the extent that such employees would not otherwise be entitled to such coverage by policy or contract (collectively, the "Medical Benefits").[5] The estimated costs for the Compensation, Business Expenses, Existing Benefits and Medical Benefits to be provided to Non-Union Employees and Union Employees are summarized on Exhibit A attached hereto.

19. To the extent that the making of only such payments described above would fail to satisfy the Debtors' obligations under any collective bargaining agreement covering any Union Employees (collectively, the "CBAs") requiring the payment of Compensation, Business Expenses, Existing Benefits and Medical Benefits, the Debtors seek the entry of an order pursuant to section 1113(e) of the Bankruptcy Code to immediately but temporarily modify such CBAs in such a manner that the payment of only such amounts with respect to the Compensation, Business Expenses, Existing Benefits and Medical Benefits would satisfy the requirements of the CBAs as so modified.

The Additional Wind-Down Motions

20. In the near future, the Debtors may also file one or more additional motions in connection with the wind-down of these estates. Those motions would deal with a

[5] To the extent a terminated or furloughed employee finds alternative employment that provides medical benefits during the 60 days after the discontinuation of the Debtors' operations, and such employee is eligible for such coverage, the Debtors may require that employee to use such alternative medical coverage as the primary coverage.

number of other matters that would enable the orderly wind-down of these estates, but which do not require relief as immediately as the relief that is requested in this Wind-Down Motion. Such items include:

a. authority to reject certain executory contracts and unexpired leases that are no longer necessary to these estates and to approve procedures to reject contracts and leases in the future;

b. the establishment of bar dates; and

c. the authority to retain one or more firms to liquidate the Debtors' assets.

Relief Requested

21. As a result of the foregoing, by this Wind-Down Motion, the Debtors seek entry of an order authorizing:

a. the Debtors to discontinue their scheduled flight operations and to take necessary or appropriate measures to implement the winding down of their affairs, including the prompt payment of Customer Refunds and the payment for all necessary goods and services and entering into contracts related thereto;

b. and directing the implementation of the Wind-Down Employee Plan for those employees that will remain with the Debtors post-discontinuation of operations to implement the wind-down of the Debtors' operations and the administration of these cases;

c. the Debtors to pay to or on behalf of its employees terminated or furloughed as a result of the discontinuation of operations (i) unpaid Compensation, Business Expenses and Existing Benefits due to employees that accrued postpetition, (ii) the priority amount of any accrued and unpaid Compensation, Business Expenses and Existing Benefits due to employees that accrued prepetition, or, if not accrued prepetition, that are calculated by reference to the prepetition priority period, up to the statutory cap of $10,000 per employee and (iii) the Medical Benefits; and

d. the Debtors, to the extent necessary, to modify the CBAs pursuant to section 1113(e) of the Bankruptcy Code, in such a manner that the payment of only the Compensation, Business Expenses, Existing Benefits and Medical Benefits in the manner described above satisfies the CBAs as so modified, with respect to the payment of such amounts.

Request to Discontinue the Debtors' Scheduled Flight Operations and Take Certain Actions in Connection Therewith

22. Pursuant to this Wind-Down Motion, the Debtors seek authority to immediately discontinue their scheduled flight operations and take all actions necessary or appropriate in furtherance thereof, including the issuance and payment of Customer Refunds and the payment for all necessary goods and services and entering into contracts related thereto.[6] As described in detail above, the necessity to discontinue scheduled flight operations has been precipitated by the Debtors' cash position and the expected cash burn from continued operations, including the requirement otherwise to make payments under aircraft leases and loans beginning on the 60th day of these cases, and their inability to secure the necessary investment in, or purchase of, the Debtors' business on a going concern basis at a price and on terms that maximize value to the Debtors' estates. Under the circumstances, it is the Debtors' business judgment that discontinuing their scheduled flight operations represents the best possible avenue to maximize the return to their creditors by accomplishing an orderly disposition of the assets of their estates.

23. Section 363(b) of the Bankruptcy Code provides in pertinent part that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b). In general, a debtor may use property of the estate outside of the ordinary course of its business where the use of such property represents an exercise of the debtor's sound business judgment. See, e.g., In re Martin, 91 F.3d 389, 395 (3d Cir. 1996) (citing Fulton State Bank v. Schipper (In re Schipper), 933 F.2d

[6] Steps that the Debtors may need to take to wind down operations include, for example, (a) securing the services of a security services firm to protect the Debtors' physical assets, (b) contracting with a third party to provide mechanics to perform the necessary changes and repairs to engines, if any, prior to the return of the Debtors' aircraft and (c) hiring temporary replacement employees to assist in the wind down process.

513, 515 (7th Cir. 1991)); see also Stephens Indus., Inc. v. McClung, 789 F.2d 386, 390 (6th Cir. 1986) (citing Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983)); In re Abbotts Dairies of Pa., Inc., 788 F.2d 143, 145-47 (3d Cir. 1986) (implicitly adopting the articulated business judgment test of Lionel Corp.).

24. In addition, section 105(a) of the Bankruptcy Code empowers a court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code]." 11 U.S.C. § 105(a). Accordingly, bankruptcy courts frequently utilize their equitable powers under section 105(a) to authorize a debtor to take actions, such as those requested here, that are consistent with the provisions of the Bankruptcy Code and that are necessary to preserve the value of a debtor's assets and estate. See, e.g., In re Decora Indus., 2002 U.S. Dist. LEXIS 27031 (D. Del. May 20, 2002) (granting debtor's motion for an order under sections 105(a) and 363 of the Bankruptcy Code authorizing the sale of substantially all of the debtors' assets, free and clear of liens, claims, interests and encumbrances); In re First Merchants Acceptance Corp., 1997 Bankr. LEXIS 1492 (Bankr. D. Del. Sept. 11, 1997) (approving the debtors' sale of the assets free and clear of all liens, claims, and encumbrances pursuant to sections 105(a) and 363(b) of the Bankruptcy Code). Accordingly, an order under section 105(a) of the Bankruptcy Code is appropriate "to carry out" the provisions of section 363(b) of the Bankruptcy Code.

25. With respect to the issuance of the Customer Refunds, virtually all of the tickets to be refunded were purchased with credit cards. To the extent the tickets were purchased after the Commencement Date, the Debtors believe that those obligations to customers are entitled to administrative priority pursuant to section 503 of the Bankruptcy Code. For tickets purchased prior to the Commencement Date, customers (or their credit card

processors) may assert that those obligations are secured or entitled to priority status pursuant to section 507(a)(7) of the Bankruptcy Code.[7] Under the Debtors' arrangements with their credit card processors, the card processors withhold all or a substantial portion of the cash from ticket sales until the air travel has been provided. Because the credit card processors generally withhold payment to the Debtors on account of those flights, the credit card processors likely will assert that their claims for chargebacks are secured by the withheld amounts. Furthermore, the failure of the Debtors to issue refunds for cancelled flights would result in chargebacks by their credit card processors, and such processors may seek to impose fees on the Debtors (in addition to the refund amounts) as a result of the chargebacks and likely will assert that such fees also are secured by withheld amounts.

26. For the reasons described in this Wind-Down Motion, the Debtors believe in their business judgment that a sound business purpose exists to discontinue their scheduled flight operations and take other necessary or appropriate actions in furtherance thereof to, among other things, preserve and maximize the value of their assets for the benefit of all of their creditors. Indeed, the current state of the Debtors' operations, cash resources and projected cash burn (including payments that otherwise would need to be made to aircraft lessors and lenders) now dictate that the Debtors' scheduled flight operations be discontinued immediately.

Request for Approval of the Wind-Down Employee Plan

27. The Debtors request authority for the implementation of the Wind-Down Employee Plan, which is designed to ensure that the Debtors can wind down their operations

[7] Section 507(a)(7) provides for seventh priority for unsecured claims of individuals for deposits in connection with the purchase of services, up to the statutory limit of $2,225.

properly, prudently and as efficiently as possible by encouraging individuals to complete specified wind down tasks. The Debtors believe that this plan is critical to winding down their operations successfully and in a manner that maximizes the values of the Debtors' estates. This Wind-Down Employee Plan applies only to certain Non-Union Employees.

28. The Wind-Down Employee Plan will include the following terms and conditions:

- An employee will be notified of the length of time that such employee will be asked to stay in the employ of the Debtors after the discontinuation of scheduled flight operations to complete his or her assigned tasks (the "Task Length").

- Except as specifically noted herein, all the Debtors' employment policies will remain in place after the discontinuation of scheduled flight operations.

- Employees with Task Lengths of less than 8 weeks will be paid for actual time worked at their current base salary rate as of the time that the Task Length is communicated to them plus benefits, except for medical and 401(k) benefits. Medical benefits are separately described below.

- Employees with Task Lengths of at least 8 weeks will be paid for actual time worked at the salary level they received immediately prior to the salary reduction that was implemented effective as of the Commencement Date plus benefits, except for medical and 401(k) benefits.[8]

- For employees with Task Lengths from one to four weeks, upon the earlier of the completion of their tasks or the expiration of their Task Length, each employee will be paid (i) a bonus (a "Completion Bonus") equal to the aggregate amount of base salary for the assigned Task Length, plus (ii) two weeks of additional pay. This payment will be in lieu of the Non-Union Severance Benefits (as defined below).

- For employees with Task Lengths greater than four weeks and up to twelve weeks, upon the earlier of the completion of their tasks or the expiration of their Task Length, each employee will be paid a Completion Bonus equal to the aggregate amount of base salary for the assigned Task

[8] Salary reductions of 5% were implemented at the beginning of the Debtors' chapter 11 cases.

Length. This payment will be in lieu of the Non-Union Severance Benefits.

- For employees with Task Lengths of six months or more, upon the earlier of the completion of their tasks or the expiration of their Task Length, each employee will be paid a Completion Bonus equal to one year's base salary at the salary level they received immediately prior to the reduction that was implemented effective as of the Commencement Date. This payment will be in lieu of any other severance payments to which any such employee would be entitled under any existing policy or contract.

- Medical benefits to all employees will continue for 60 days after the discontinuation of the Debtors' scheduled flight operations, after which such benefits will be discontinued. All employees still employed by the Debtors under the Wind-Down Employee Plan after medical benefits terminate will receive an additional $1,000 per month in lieu of medical benefits following the expiration of the 60 day period. The Debtors estimate that the aggregate cost of these payments will be approximately $112,000.

- Completion Bonuses will not be pro-rated, except in the case of death or disability. If the Debtors release an employee for other than cause prior to the end of his or her assigned Task Length, the Completion Bonus will be paid in full. If the employee voluntarily terminates his or her employment or is discharged for cause prior to the end of the assigned Task Length, no Completion Bonus will be paid.

- To the extent necessary, the Debtors will request authority to supplement the Wind-Down Employee Plan after the initial six month period.

29. The expected Task Lengths for the Wind-Down Employee Plan, and the anticipated number of employees and costs for each category (including payroll taxes), are as follows:

Task Length	Estimated Number of Employees Needed	Estimated Payroll	Estimated Aggregate Completion Bonus
6 months and beyond	22	$1,063,414	$2,126,772
12 weeks	13	$292,425	$292,425
8 weeks	32	$305,812	$305,812
6 weeks	11	$56,858	$56,858
2-4 weeks	60	$206,194	$351,733
1 week	42	$36,644	$109,933
Total	180	$1,961,347	$3,243,533

30. The Debtors reserve the right to modify the Wind-Down Employee Plan as needed, but consistent generally with the terms described above, and request that the estates be authorized to pay total compensation under the Wind-Down Employee Plan of up to $5.5 million.

31. Pay and benefits to be provided under the Wind-Down Employee Plan have been developed by the Debtors in their business judgment based upon the Debtors' planning efforts, and are based upon the Debtors' estimates of the expected periods of employment needed of each employee to complete the wind-down tasks. The Wind-Down Employee Plan is designed to assure that employees are incentivized to complete the important task of properly winding down the Debtors' operations. The Debtors believe that these employees are necessary to wind down their operations and to assist in the administration of these chapter 11 cases. Accordingly, the Wind-Down Employee Plan is a vital tool to ensure that the Debtors can achieve these goals.

32. By this Wind-Down Motion, the Debtors request, pursuant to section 363(b) of the Bankruptcy Code, that the estates be authorized and directed to implement the Wind-Down Employee Plan. Section 363(b) of the Bankruptcy Code permits a debtor to use property of the estate outside of the ordinary course of its business where the use of such property represents an exercise of the debtor's sound business judgment. See, e.g., In re Martin, 91 F.3d 389, 395 (3d Cir. 1996). The Debtors believe that the implementation of the Wind-Down Employee Plan is justified under these circumstances, will accomplish a sound business purpose and will assist in the effective and efficient wind-down of the Debtors' operations. Based on their evaluation of available alternatives, the Debtors have determined that the

measures proposed herein are necessary to achieve, and will achieve, their intended purpose of properly winding down the Debtors' operations.

33. For the reasons set forth below, the Debtors submit that the Wind-Down Employee Plan does not conflict with newly enacted section 503(c)(1) of the Bankruptcy Code.[9] Section 503(c)(1) only applies to payments that are meant to induce insiders to "remain with the [debtors'] business" by requiring, among other things, that a debtor demonstrates that the insider (a) has a bona fide job offer from another business and (b) is "essential to the survival of the business." 11 U.S.C. § 503(c)(1)(A) and (B). As a preliminary matter, section 503(c)(1), if applicable, would potentially apply only to a few employees in the case of the Wind-Down Employee Plan. The precise contours of the term "insider" as defined in section 101(31) of the Bankruptcy Code are unclear.[10] However, the Debtors suggest that, for the purpose of section 503(c)(1), the term insider applies in the case of the Wind-Down Employee Plan only to executive officers (and not, for example, to someone merely holding a title of "vice president"

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[9] Section 503(c)(1) prohibits a transfer made to "an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that —

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the businesses; and

(C) either —

(i) the amount of the transfer made to . . . the person is not greater than the amount equal to 10 times the amount of the mean transfer . . . of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made . . .; or

(ii) if no such similar transfers were made to . . . such nonmanagement employees during such calendar year, the amount of the transfer . . . is not greater than an amount equal to 25 percent of the amount of any similar transfer . . . made to . . . such insider for any purpose during the calendar year before the year in which such transfer is made . . . ."

[10] See In re NMI Systems, Inc., 179 B.R. 357 (Bankr. D.D.C. 1995).

or similar position). In that case, there are less than ten executive officers of the Debtors that will be covered by the Wind-Down Plan, and only a few of those are scheduled to remain employed by the Debtors for 12 or more weeks.

34. Here, even for the insiders, section 503(c) does not apply here for two reasons. First, as of January 6, 2006, there will not be a "business" of the Debtors, as that term is used in section 503(c)(1). Section 503 precludes payments to insiders to induce such insiders to remain with the debtor's business unless certain conditions are met. One condition, set forth in section 503(c)(1)(B), is that the services provided by that person are "essential to the survival of the business." If "business" in section 503 were construed to mean something other than a viable commercial enterprise, no retention payments could ever be made to insiders in a liquidating chapter 11 case. A liquidation, by definition, means the "business" will not survive, and hence the employee's service cannot be essential to the survival of the business. Thus, for purposes of section 503(c), a business should mean a viable commercial enterprise. Compare Official Comm. of Unsecured Creditors of United Healthcare System, Inc. v. United Healthcare System, Inc. (In re United Healthcare System, Inc.), 200 F.3d 170 (3d Cir. 1999) (finding that a debtor that had ceased operations was no longer an "employer" for purposes of the WARN Act, and thus was not subject to the Act's notification requirements when it terminated its employees)

35. Second, even if the Debtors still were a "business" for purposes of section 503(c)(1) after they discontinue scheduled flight operations, the Wind-Down Employee Plan is not intended to "induce" anyone to "remain with the Debtors' business." Instead, the Wind-Down Employee Plan is intended to create incentives for employees to wind down the Debtors' affairs, liquidate their assets, and efficiently administer their bankruptcy estates. On

January 5, 2006, the Debtors' business will discontinue, and the Debtors (if the Wind-Down Rejection Motion is granted) will no longer own or lease any aircraft recently used in their business.

36. For employees, there is a critical distinction in job function between (a) working as part of a team whose goal is to operate an efficient and growing airline (i.e., working to remain with the debtor's business) and (b) working to liquidate miscellaneous assets, reconcile claims, return aircraft and close the books (i.e., literally working oneself out of a job). Moreover, there is a fundamental economic difference between remaining with a business and liquidating an estate — the former offers a relatively secure job and the prospect of career advancement (with raises) and potential performance bonuses; the second offers only certain unemployment within a fixed period. Thus, while base compensation, performance bonus, and the prospects of future employment may be sufficient to induce employees to remain with the going concern business that the insider willingly joined (arguably in certain cases making retention bonuses potentially appear superfluous absent a bona fide job offer), such considerations do not apply when there are no prospects of future employment and a fundamental change in job description because the debtor has discontinued operations. Accordingly, the Debtors submit that section 503(c)(1) simply does not apply in the circumstances presented here because the Wind-Down Employee Plan is not an inducement to remain with a going concern business.

37. Alternatively, if the Court finds that the Wind-Down Employee Plan contravenes section 503(c) with respect to insiders, the Debtors intend to seek authority, at their election, to (a) enter into postpetition employment agreements with insiders otherwise covered by section 503(c)(1) at a base salary equal to the amounts payable under the Wind-Down

Employee Plan, (b) terminate the employment of such insiders and enter into consulting agreements with such parties as independent contractors, (c) demote such persons so that they are no longer "insiders" covered by section 503(c) or (d) establish incentive-based bonuses (on the assumption that they do not fall within the ambit of section 503(c)) that can be satisfied by such insiders. The Debtors believe that any of these alternatives may pass muster under section 503(c) for "insiders." However, such arrangements may be less effective and/or more costly to the Debtors' estates to achieve the Debtors' wind down goals.

38. Finally, the level of compensation proposed to be paid in the Wind-Down Employee Plan is appropriate. The employees slotted to remain with the Debtors are crucial to an orderly and efficient wind down of the Debtors' estates. As noted above, winding down an estate is a dead-end job with no prospect of advancement. Many of these employees — particularly those in the finance and information technology areas — may be highly mobile, and could quickly find alternative employment. Thus, not only must they be compensated for their base salary but for their opportunity costs as well. If a highly mobile employee remains with the Debtors' estates, such employee is being asked to stay out of the job market now, and thus risks losing out on potential opportunities. At a minimum, the employee is being asked to forego perhaps six months of seniority at the new job, which could have a material impact on opportunities and compensation with the new employer. On top of the opportunity costs, the amount of the Completion Bonus must be considered in light of the Debtors' below-market salary scale and the fact that, unlike in many other jobs, there is no "upside" potential in the form of performance bonus, stock options, 401(k) matching or other similar benefits.

39. In light of the foregoing, the Debtors believe that the terms of the Wind-Down Employee Plan are justified, reasonable and appropriate under the circumstances. The

Debtors therefore submit that the approval of the Wind-Down Employee Plan should be granted, pursuant to section 363(b) of the Bankruptcy Code.

Request for Authority to Pay Certain Wages, Severance, Vacation and Other Benefits and Amounts to Terminated or Furloughed Employees

40. Unfortunately, the Debtors will be required to terminate the services of thousands of loyal employees. The Debtors' employees have continued to provide exemplary services throughout these cases — continuing to maintain the Debtors' operations at a premium operating level as evidenced by the continuing operational milestones that the Debtors have achieved as well as the industry accolades and recognition that the Debtors' customer services has received.

41. Accordingly, the Debtors seek authority to pay to or on behalf of those employees terminated or furloughed as a result of the discontinuation of scheduled flight operations (a) unpaid Compensation, Business Expenses and Existing Benefits that accrued postpetition, (b) the priority amounts of any unpaid Compensation, Business Expenses and Existing Benefits due to employees that accrued prepetition, or, if not accrued prepetition, that are calculated by reference to the prepetition priority period, up to the statutory cap of $10,000 per employee and (c) the Medical Benefits. The Debtors request authority to make such payments, in the case of Non-Union Employees, pursuant to established practices and policies currently in effect, and, in the case of Union Employees, pursuant to the terms of the applicable CBA, up to the limits and priorities established in the Bankruptcy Code.

42. Set forth on the attached Exhibit A are the Debtors' estimates of the maximum amounts of Compensation, Business Expenses, Existing Benefits and Medical

Benefits that would be paid to the Debtors' union and non-union employees that are furloughed or terminated as a result of the Debtors' discontinuation of flight operations.[11]

Non-Union Employees

43. Two significant components of the Compensation to be provided to Non-Union Employees upon their termination are severance and vacation. Prior to the Commencement Date, the Debtors' severance program for Non-Union Employees terminated for other than cause provided for the employee to receive a severance benefit equal to one week of pay for every year of service with the Debtors, up to a maximum of four or eight weeks depending on the position of the employee. The Debtors noted in their first day employee motion (D.I. 7) their intention to modify their severance program during these chapter 11 cases to provide for Non-Union Employees to receive a flat severance payment equal to two weeks of pay for each terminated employee (regardless of years of service). That payment also would be reduced, dollar for dollar, by any amounts paid to such employee under any applicable law (such as the WARN Act (as such term is defined below)) related to the termination of such employee's employment or notice thereof (the "Non-Union Severance Benefits").[12] The Debtors announced to their employees the implementation of the revised Non-Union Severance Benefits in early December 2005, and seek authority in this Wind-Down Motion to pay this two weeks of severance to Non-Union Employees, subject to offset for WARN Act or similar obligations. These Non-Union Severance Benefits represent administrative expenses of the

[11] Such amounts will need to be reconciled on an employee by employee basis. Nothing contained herein shall be construed as an admission of the validity, priority or nature of any claim described herein.

[12] On the Commencement Date, the Debtors gave notice to all of its employees pursuant to the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 et seq. (the "WARN Act"), of their potential termination as of January 7, 2006, which is less than two days after the date that the Debtors now intend to discontinue operations and terminate most of their Non-Union Employees.

Debtors' estates. See, e.g., Former Employees of Builders Square Retail Stores v. Hechinger Investment Co. of Delaware (In re Hechinger Investment Co. of Delaware), 298 F.3d 219, 227 (3d Cir. 2002) (noting a distinction in the Third Circuit "between '(i) pay at termination in lieu of notice; and (ii) pay at termination based on length of employment,' with the prior receiving administrative expense priority and the latter receiving no additional priority other than that allowed under § 507(a)(3).") (citing In re Roth American, Inc., 975 F.2d 949, 957 (3d Cir. 1992)).

44. As to vacation pay, the Debtors seek authorization to pay Non-Union Employees upon termination their unused vacation pay that accrued postpetition, and that accrued prepetition up to the $10,000 cap set forth in section 507(a)(4) of the Bankruptcy Code (the "Non-Union Vacation Benefits"), consistent with the policy covering the Non-Union Vacation Benefits announced and implemented in early December 2005. The Debtors also seek authority to continue to pay Medical Benefits to Non-Union Employees for 60 days after the discontinuation of the Debtors' scheduled flight operations.

45. As set forth on the attached Exhibit A, the Debtors estimate the aggregate cost to the Debtors' estates for the Compensation, Business Expenses, Existing Benefits and Medical Benefits, including Non-Union Severance Benefits and Non-Union Vacation Benefits, to be paid to or on behalf of Non-Union Employees upon their termination (collectively, the "Non-Union Termination Benefits") to be $6,040,000.[13]

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[13] The prepetition portion of the Termination Benefits (as defined below) that are entitled to priority pursuant to sections 507(a)(4) and 507(a)(5) of the Bankruptcy Code will be subject to the $10,000 cap set forth in those sections. In calculating the cap for each employee, the Debtors will take into account any priority prepetition amounts previously paid to such employee during these cases.

Union Employees

46. The primary components of the Compensation, Business Expenses and Existing Benefits owed to the Union Employees that will be terminated or furloughed are set forth in the CBAs. The Debtors are parties to CBAs with three unions (the "Unions") representing the Debtors' workers: the Air Line Pilots Association, International ("ALPA"), the Association of Flight Attendants-Communication Workers of America ("AFA-CWA"), and the Aircraft Mechanics Fraternal Association ("AMFA"). Under the CBAs, the Debtors' unionized employees are entitled to certain benefits upon their furlough as follows: (a) 14 days of advance notice of furlough, or pay in lieu thereof (ALPA, AFA-CWA, AMFA), with certain exceptions; (b) severance pay of one week for full-time employees with at least one full year of service, and of two weeks for full-time employees with at least two full years of service (AMFA) (collectively with (a), the "Union Severance Benefits"); (c) payment for all vacation earned but not taken and accrued vacation (ALPA, AFA-CWA, AMFA) ("Union Vacation Benefits"); (d) company-paid group insurance premiums the first 30 days of the furlough (AFA-CWA) and eligibility for continuation of benefits under COBRA (AMFA) and/or applicable federal and state laws (AFA-CWA); and (e) entitlement generally to coverage under medical and dental plans on the same terms as other, nonunion employee groups covered by the plans (ALPA, AFA-CWA) (collectively with (d), the "Existing Union Medical Benefits").

47. In addition to the authority to pay terminated or furloughed Union Employees the administrative and priority amounts of any unpaid Compensation, Business Expenses and Existing Benefits that may be required by the CBAs, including Union Severance Benefits and the Union Vacation Benefits, the Debtors seek authority to continue to pay Medical Benefits to Union Employees for 60 days after the discontinuation of the Debtors' scheduled flight operations in lieu of the Existing Union Medical Benefits. This would be

consistent with the Medical Benefits that are being provided to terminated Non-Union Employees and would provide greater healthcare benefits to the terminated or furloughed Union Employees than they would receive under the CBAs.

48. As set forth on the attached Exhibit A, the Debtors estimate the aggregate cost to the Debtors' estates for the Compensation, Business Expenses, Existing Benefits and Medical Benefits, including Union Severance Benefits and Union Vacation Benefits, to be paid to Union Employees upon their termination or furlough (collectively, the "Union Termination Benefits") to be $5,260,000. The Non-Union Termination Benefits and the Union Termination Benefits are referred to herein as the Termination Benefits.

49. The Debtors believe that the payment of the Union Termination Benefits is generally consistent with the CBAs, though there may be instances in which the CBAs would provide for payments upon furlough or termination of certain non-priority prepetition amounts. To the extent that the Court finds that the payment of the Union Termination Benefits differs in any way from the obligations imposed by the CBAs, the Debtors hereby request the modification of the CBAs pursuant to section 1113(e) of the Bankruptcy Code to permit the payment of only the Union Termination Benefits as specified herein.

50. Section 1113(e) of the Bankruptcy Code empowers a court, after notice and hearing, to "authorize the trustee to implement interim changes in the terms, conditions, wages, benefits or work rules provided by a collective bargaining agreement" if such changes are "essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate." 11 U.S.C. § 1113(e). This standard for interim relief is disjunctive; a debtor need only show one of the two conditions in order to be entitled to relief under section 1113(e). See In re United Press Int'l, Inc., 134 B.R. 507, 514 (Bankr. S.D.N.Y. 1991).

Here, granting Debtors' request for interim relief from the CBAs would enable the Debtors to avoid irreparable damage to their estates that otherwise would be occasioned by paying out to Union Employees more than the Bankruptcy Code dictates is permissible pursuant to the priority scheme set forth in section 507 of the Bankruptcy Code. Thus, granting the request is appropriate as a matter of law. See Beckley Coal Mining Co. v. United Mine Workers, 98 B.R. 690, 694 (D. Del. 1988) (recognizing the possibility that irreparable harm might result if a debtor depleted all of its cash) (citing Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America, 791 F.2d 1074, 1085 (3d Cir. 1986)); see also In re Almac's, Inc., 169 B.R. 279, 281 (Bankr. D.R.I. 1994) (finding modification of the CBA necessary to avoid irreparable damage). Granting this relief at this time would promote the underlying purpose of section 1113(e), which "necessarily contemplates a temporary measure to provide time to the parties to resolve their differences and for the best interests of all parties seeking solutions to their existing agreement." In re Russell Transfer, Inc., 48 B.R. 241, 244 (Bankr. W.D. Va. 1985).

Request for Payment of Termination Benefits

51. The Debtors believe that the payment to employees of the Termination Benefits as requested herein is a reasonable exercise of their business judgment and a sound use of the Debtors' assets pursuant to sections 105 and 363 of the Bankruptcy Code. The Debtors believe that many employees relied on these benefits in deciding to remain in the employ of the Debtors following the commencement of these chapter 11 cases, despite the highly uncertain status of the Debtors' future operations. In addition, all of the Termination Benefits to be provided herein, other than the Medical Benefits, would be entitled to administrative or priority status pursuant to section 503 or 507 of the Bankruptcy Code. Thus, each would likely be paid in full eventually in any event. With respect to the Medical Benefits, the Debtors believe that it

is appropriate to provide health care coverage to their terminated or furloughed employees in the short term to allow them sufficient time to find alternative coverage.

52. The next few weeks will be a very difficult time for the Debtors' loyal employees as they seek new employment, so the Debtors wish to pay the Termination Benefits as quickly as possible or appropriate to ease the employees' transition period and to avoid the administrative burdens of the employees, and the Debtors, of the bankruptcy claims process for these payments. Accordingly, the Debtors request authority to immediately pay the Termination Benefits to their severed or furloughed employees.

Reservation of Rights

53. Nothing contained herein is intended or shall be construed as: (a) an admission as to the validity, priority, or nature of any claim against the Debtors; (b) a waiver of the Debtors' rights to dispute any claim on any grounds; (c) an implication or admission that any particular claim against the Debtors would constitute a claim described herein; or (e) a request or authorization to assume any agreement, contract, or lease pursuant to section 365 of the Bankruptcy Code.

Waiver of Stay

54. Given the extreme jeopardy to the estates posed by any delay in discontinuation the Debtors' scheduled flight operations, the Debtors desire to commence such discontinuation immediately upon the entry of the order approving this Wind-Down Motion. Accordingly, the Debtors hereby request that the Court, in the discretion provided to it under Rule 6004(g) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"),[14] waive

[14] Bankruptcy Rule 6004(g) provides that, "an order authorizing the use, sale, or lease of property other than cash collateral is stayed until the expiration of 10 days after the entry of the order, unless the court orders otherwise."

the ten-day stay of the order approving this Wind-Down Motion arising under such Bankruptcy Rule. The Debtors submit that the exigency of their present circumstances, described in great detail above, warrants a waiver of the stay imposed by Bankruptcy Rule 6004(g). See In re Decora Indus., Inc., Case No. 00-4459 (JJF), 2002 WL 32332749, at *9 (D. Del. May 20, 2002) (waiving the 10-day stay imposed by Bankruptcy Rule 6004(g)); In re Chi-Chi's, Inc., Case No. 03-13063 (JLP), 2004 WL 2848901, at *3 (Bankr. D. Del. Dec. 6, 2004) (same).

Notice

55. No trustee or examiner has been appointed in these chapter 11 cases. Notice of this Wind-Down Motion has been provided to: (a) the United States Trustee; (b) counsel to the Committee; (c) the Unions; and (d) parties entitled to receive notices under Rule 2002 of the Federal Rules of Bankruptcy Procedure. In light of the nature of the relief requested, the Debtors submit that no further notice need be given.

WHEREFORE, the Debtors respectfully request that the Court enter an order substantially in the form attached hereto as Exhibit B: (a) granting the relief requested herein; and (b) granting to the Debtors such other and further relief as the Court may deem proper.

Dated: Wilmington, Delaware
January 2, 2006

YOUNG CONAWAY STARGATT & TAYLOR, LLP

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Counsel to the Debtors

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	Case No. 05-20011 (MFW)
FLYi, Inc., *et al.*,	)	(Jointly Administered)
	)	
	)	**Hearing Date: January 5, 2006 @ 10:00 am**
Debtors.	)	
	)	

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CLERK
US BANKRUPTCY COURT
DISTRICT OF DELAWARE

OBJECTION OF ASSOCIATION OF FLIGHT ATTENDANTS TO EMERGENCY MOTION OF THE DEBTORS FOR AN ORDER (I) AUTHORIZING THEM TO DISCONTINUE THEIR SCHEDULED FLIGHT OPERATIONS AND TAKE CERTAIN ACTIONS IN CONNECTION THEREWITH; (II) APPROVING THE PAYMENT OF CERTAIN SEVERANCE, VACATION AND OTHER BENEFITS AND AMOUNTS TO TERMINATED OR FURLOUGHED EMPLOYEES; AND (IV) TO THE EXTENT NECESSARY, AUTHORIZING THE MODIFICATION OF COLLECTIVE BARGAINING AGREEMENTS PURSUANT TO SECTION 1113(e) OF THE BANKRUPTCY CODE IN CONNECTION THEREWITH [Re D.I. 417]

The Association of Flight Attendants – CWA (the "AFA"), the union representing approximately 400 flight attendants employed by the Debtors under collective bargaining agreements, by and through its undersigned counsel, hereby submits this objection (the "Objection") to the Emergency Motion of the Debtors for an Order (I) Authorizing Them to Discontinue Their Scheduled Flight Operations and Take Certain Actions in Connection Therewith; (II) Approving the Payment of Certain Severance, Vacation and Other Benefits and Amounts to Terminated or Furloughed Employees; and (IV) to the Extent Necessary, Authorizing the Modification of Collective Bargaining Agreements Pursuant to Section 1113(c) of the Bankruptcy Code in Connection Therewith (D.I. 417) (the "Emergency Motion"). In support of this Objection, AFA states as follows:

BACKGROUND

1. On November 7, 2005 (the "Petition Date"), the above-captioned debtors-in-possession (collectively "FLYi" or the "Debtors") each filed for relief under chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code").

2. The Debtors continue to operate their businesses and manage their property as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

3. On January 2, 2006, the Debtors filed the Emergency Motion, which stated, among other things, that the Debtors' attempt to sell the company as a going concern had failed and that the Debtors were shifting their efforts toward winding down operations. The Debtors have stated that they will terminate or furlough approximately 2,520 employees, 1,300 of whom are a party to collective bargaining agreements.

4. As part of the planned wind down (as set forth in the Emergency Motion, the "Wind Down Plan"), the Debtors seek by the Emergency Motion to (i) discontinue operations, (ii) pay termination benefits to employees who are terminated as a result of the shut down, and (iii) modify collective bargaining agreements entered into between the AFA and the Debtors.

5. More specifically, the Debtors have requested authority to pay (a) unpaid wages, salaries, commissions and sick leave used prior to termination, vacation pay and severance pay, (b) business expenses not previously reimbursed and (c) contributions to employee benefit plans and benefits thereunder. The Debtors request to pay such compensation, expenses and benefits to each employee to the extent that each employee is entitled under existing policies or collective bargaining agreements. The Debtors seek authority to make such payments for amounts accrued prepetition to the extent of the $10,000 statutory cap of sections 507(a)(4) and (5) of the Bankruptcy Code and without limit for amounts that accrued post-petition.

6. Further, the Debtors seek to retain after January 5, 2005, up to 180 employees for periods ranging from one week to more than six months and to pay bonuses to those employees in addition to normal wages and salaries. For employees being retained for one to four weeks, the employees will receive, in addition to their regular pay, a bonus in the amount of their regular base pay for the extended employment period plus an additional two-weeks' pay. Employees retained for four weeks to six months, will receive, in addition to their regular pay, a bonus in the amount of their regular wage for the period of extended employment. Employees retained for six months or longer will receive a bonus equal to one-year's base pay. The proposed "Wind-Down Employee Plan" is more fully set forth at paragraph 28 of the Emergency Motion.

OBJECTION

7. The AFA objects to the Emergency Motion and the proposed Wind-Down Plan to the extent that the Debtors seek to provide bonuses to Wind-Down Employees while more than 2,000 employees are terminated. The AFA believes that extended employment at regular pay rates is reward enough for the Wind-Down Employees. Providing those employees with bonuses is a "slap in the face" to employees who will not be retained, an improper use of estate assets and contrary to basic notions of fairness and equity.

8. Additionally, the newly enacted Section 503(c)(1) should be applied to the Wind-Down Employee Plan. The Debtors attempt to avoid the effects of the new law by arguing that as a liquidating case, the "survival of the business" is not at stake. This interpretation cannot be reconciled with Section 1108 of the Bankruptcy Code. Certainly, debtors-in-possession in liquidating Chapter 11 cases are still deemed to "operate their business." Therefore, this Court

should approve the Wind-Down Employee Plan only to the extent that is complies with Section 503(c)(1).

9. The AFA further objects to the Emergency Motion to the extent that it seeks to modify existing Collective Bargaining Agreements ("CBA") under section 1113(e) of the Bankruptcy Code or otherwise. This Court may only modify a collective bargaining agreement after notice and a hearing and "if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate." 11 U.S.C. § 1113(e).

10. Despite this high standard, paragraph 49 of the Emergency Motion merely states vaguely that "to the extent that the Court finds that the payment of the Union Termination Benefits differs in any way from the obligations imposed by the CBAs, the Debtors hereby request the modification of the CBAs." The Debtors have not articulated any specific expectation that they will have to modify the CBAs, or detailed to what extent they may do so. There is no meaningful way for the AFA or union employees to evaluate any proposed or veiled modification of the CBAs. There is also no way for this Court to hold an adequate hearing to determine whether the proposed modification is necessary to "avoid irreparable damage to the estate."

11. Thus, the 1113(e) relief sought in the Emergency Motion should be denied and the obligations contained in the CBAs should be fully enforced as currently written.

12. AFA hereby expressly reserves the right to amend, modify and/or supplement this Objection in any way and to impose other objections to the Wind-Down Plan, and to present such evidence as AFA deems appropriate in connection with any hearing to consider this Objection or the Emergency Motion.

WHEREFORE, AFA respectfully requests that the Court sustain the Objection and deny the Emergency Motion consistent with this Objection.

Dated: January 4, 2006
Wilmington, Delaware

FLASTER/GREENBERG P.C.

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Counsel to Association of Flight Attendants - CWA

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re	:	Chapter 11
FLYi, Inc., *et al.*,[1]	:	Case No. 05-20011 (MFW)
Debtors.	:	(Jointly Administered)
	:	**Ref. Docket No. 417**

ORDER (I) AUTHORIZING THE DEBTORS TO DISCONTINUE THEIR SCHEDULED FLIGHT OPERATIONS AND TAKE CERTAIN ACTIONS IN CONNECTION THEREWITH; (II) APPROVING A WIND-DOWN EMPLOYEE PLAN; (III) APPROVING THE PAYMENT OF CERTAIN SEVERANCE, VACATION AND OTHER BENEFITS AND AMOUNTS TO TERMINATED OR FURLOUGHED EMPLOYEES; AND (IV) TO THE EXTENT NECESSARY, AUTHORIZING THE MODIFICATION OF COLLECTIVE BARGAINING AGREEMENTS PURSUANT TO SECTION 1113(e) OF THE BANKRUPTCY CODE IN CONNECTION THEREWITH

This matter coming before the Court on the motion (the "Motion")[2] of the above-captioned debtors (collectively, the "Debtors") for the entry of an order pursuant to sections 105(a), 363 and 1113(e) of title 11, United States Code (the "Bankruptcy Code"): (i) authorizing them to discontinue their scheduled flight operations and take certain actions in connection therewith; (ii) approving a wind-down employee plan; (iii) approving the payment of certain severance, vacation and other benefits and amounts to terminated or furloughed employees; and (iv) to the extent necessary, authorizing the modification of collective

[1] The Debtors are the following seven entities (the last four digits of their respective taxpayer identification numbers, if any, follow in parentheses): FLYi, Inc. (1051); Independence Air, Inc. (1749); Atlantic Coast Jet, LLC (1492); Atlantic Coast Academy, Inc. (9852); IA Sub, Inc. (none); WaKeeney, Inc. (none); and Atlantic Coast Airlines, Inc. (none). The address of each of the Debtors is 45200 Business Court, Dulles, VA 20166.

[2] Capitalized terms not otherwise defined herein have the meanings given to them in the Motion.

bargaining agreements in connection therewith; the Court having reviewed the Motion, and having heard the statements of counsel and evidence adduced with respect to the Motion at a hearing before the Court on the Motion (the "Hearing"); and after due deliberation the Court having determined that good and sufficient cause having been shown;

THE COURT HEREBY FINDS AND DETERMINES THAT:

A. The findings and conclusions set forth herein constitute the Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), made applicable to this proceeding pursuant to Bankruptcy Rule 9014.

B. To the extent any of the following findings of fact constitute conclusions of law, they are adopted as such. To the extent any of the following conclusions of law constitute findings of fact, they are adopted as such.

C. The Court has jurisdiction over the Motion and the discontinuation of the Debtors' scheduled flight operations pursuant to 28 U.S.C. §§ 157 and 1334, and this matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (N). Venue of these cases and the Motion in this district is proper under 28 U.S.C. §§ 1408 and 1409.

D. The statutory predicates for the relief sought in the Motion are sections 105(a), 363 and 1113(e) of title 11 of the United States Code (the "Bankruptcy Code"), as supplemented by Bankruptcy Rules 2002 and 6004.

E. As evidenced by the affidavits of service filed with the Court, (i) proper, timely, adequate and sufficient notice of the Motion and the Hearing has been provided in accordance with Bankruptcy Rules 2002(a) and 6004(a), (ii) such notice was good and sufficient, and appropriate under the particular circumstances and (iii) no other or further notice of the Motion and the Hearing is or shall be required.

F. The Debtors' current cash and financial position supports the immediate discontinuation of the Debtors' scheduled flight operations.

G. Approval of the discontinuation of the Debtors' scheduled flight operations is in the best interests of the Debtors, their creditors, their estates and other parties in interest.

H. The Debtors have demonstrated a good, sufficient, and sound business purpose and justification for the discontinuation of their scheduled flight operations and taking certain actions in connection therewith.

I. The Debtors have articulated a sound business purpose for the approval and implementation of the Wind-Down Employee Plan and have sought such approval in their sound business judgment. The approval of the Wind-Down Employee Plan to the extent set forth herein is in the best interests of the Debtors, their creditors, their estates and other parties in interest.

J. The Debtors have articulated a sound business purpose for the approval and payment of the Termination Benefits and have sought such approval in their sound business judgment. The approval of the Termination Benefits is in the best interests of the Debtors, their creditors, their estates and other parties in interest.

K. Either (1) the payment of the Union Termination Benefits satisfies the Debtors' payment obligations under the CBAs to Union Employees that are furloughed or terminated due to the discontinuation of the Debtors' scheduled flight operations for amounts that are entitled to administrative or priority status pursuant to sections 503 or 507 of the

Bankruptcy Code, or (2) it is essential to avoid irreparable damage to the Debtors' estates to modify the CBAs pursuant to section 1113(e) to provide for only such benefits.

L. The Debtors have articulated good and sound business reasons for waiving the stay otherwise imposed by Bankruptcy Rule 6004(g).

IT IS HEREBY ORDERED THAT:

1. The Motion is GRANTED as provided herein.

2. The discontinuation of the Debtors' scheduled flight operations is hereby approved, pursuant to sections 105(a) and 363(b) of the Bankruptcy Code. The Debtors, and their directors, officers, employees, professionals and other agents, are authorized, pursuant to sections 105(a) and 363(b) of the Bankruptcy Code and without further relief from the Court, to take any and all actions that are necessary or appropriate in the exercise of their business judgment to discontinue the Debtors' operations and to wind-down the Debtors' affairs, including the issuance and payment of Customer Refunds and the payment for all necessary goods and services and entering into contracts related thereto, including, without limitation, agreements with General Electric Capital Corporation and certain of its affiliates with respect to the use of spare parts and spare engines (including to the extent any such agreement is an agreement contemplated by section 1110(b) of the Bankruptcy Code, if applicable).

3. Notwithstanding the discontinuation of the Debtors' scheduled flight operations and wind-down of their affairs, the Debtors shall continue to pay Governmental Fees and Passenger Facility Charges (both as defined in the Motion of the Debtors for an Order (I) Authorizing them to Pay Certain Prepetition Governmental Obligations and (II) granting Certain Related Relief [Docket No. 15]) as such obligations become due to the Transportation

Security Administration, airports or under certain circumstances to customers entitled to ticket refunds.

4. The Wind-Down Employee Plan, as modified herein, is hereby approved, pursuant to section 363(b) of the Bankruptcy Code, and any amounts due and owing to employees covered by the Wind-Down Employee Plan as so modified shall be paid as and when due. The Debtors' estates are authorized and directed to take any and all actions that are necessary or appropriate to implement the Wind-Down Employee Plan as so modified. The Debtors, in consultation with the Committee, may modify the Wind-Down Employee Plan, as needed, in a manner consistent generally with the terms of the Wind-Down Employee Plan described in the Motion and as further modified on Schedule 1 hereto, provided that the total compensation paid under the Wind-Down Employee Plan shall not exceed $4.4 million. The categories of employees for the Wind-Down Employee Plan and the corresponding compensation amounts set forth in ¶ 29 of the Motion is modified pursuant to the chart set forth on Schedule 1 hereto. Notwithstanding anything herein, the Motion with respect to the request to make payments under the Wind-Down Employee Plan to six "insiders" as set forth on the record at the Hearing is hereby adjourned to January 12, 2006 at 11:30 a.m.

5. The payment of the Termination Benefits is hereby approved, pursuant to section 363(b) of the Bankruptcy Code and any amounts due and owing to terminated or furloughed employees may be paid as described in the Motion. The Debtors are authorized to take any and all actions that are necessary or appropriate in the exercise of their business judgment to pay the Termination Benefits.

6. To the extent necessary, the CBAs are hereby immediately but temporarily modified pursuant to section 1113(e) of the Bankruptcy Code in such a manner that

the payment upon furlough or termination of the Union Employees of only the Union Termination Benefits in the manner set forth in the Motion and this Order satisfies the requirements of the CBAs as so modified, provided however that the relief granted herein under pursuant to section 1113 shall not be deemed to preclude the assertion by any party of any claim or the right to dispute the calculation of any payments made pursuant to this Order in each case determined in accordance with the provision of the Bankruptcy Code without giving effect, if any, to section 1113 of the Bankruptcy Code to alter treatment of such claim as otherwise provided by the Bankruptcy Code or the right of the Debtors' estates to dispute such claim or calculation.

6. A. The representations and agreements of the Debtors and MWAA read into the record at the Hearing are incorporated herein, approved and so Ordered.

7. The terms and provisions of this Order shall be binding in all respects, and shall inure to the benefit of, the Debtors, their estates, creditors and interest holders and their respective affiliates, successors and assigns.

8. The stay of this Order imposed by Bankruptcy Rule 6004(g) is hereby waived.

9. This Court retains jurisdiction over any and all matters or disputes with respect to any of the relief granted in this Order.

10. In the event General Electric Capital Corporation, its agents or affiliates (collectively, "GECC") is entitled to the surrender and return of collateral entitled to protection under section 1110 of the Bankruptcy Code granted in connection with the Debtors' spare parts and engine loan with GECC (the "Spare Parts Loan"), then the Debtors may authorize, in their discretion, the contemporaneous surrender and return of any collateral granted under the Spare Parts Loan which is not entitled to protection under section 1110 of the Bankruptcy Code, if any, and that the automatic stay under section 362 of the Bankruptcy Code shall be modified, to the extent applicable, to permit such surrender and return.

Dated: Wilmington, Delaware
January 5, 2006

Mary F. Walrath
MARY F. WALRATH
CHIEF UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION**

In re:

HUFFY CORPORATION, an Ohio corporation, et al.[1]	)	**Chapter 11**
	)	**Honorable Lawrence S. Walter**
Debtors.	)	
		Case Nos. 04-39148 through 04-39167 Jointly Administered

DEBTORS' MOTION FOR AN ORDER DETERMINING THAT DEBTORS MEET THE REQUIREMENTS FOR A DISTRESS TERMINATION OF THE HUFFY CORPORATION RETIREMENT PLAN AND APPROVING TERMINATION OF THE PLAN

1. The above-captioned debtors and debtors in possession (collectively, the "Debtors" or the "Company"), pursuant to Section 363(b) of the Bankruptcy Code, 11 U.S.C. § 363(b), and Section 4041 of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1341, hereby move the Court for an order determining that Debtors meet the requirements for a voluntary distress termination of the Huffy Corporation Retirement Plan (the "Plan") under 29 U.S.C. § 1341(c)(2)(B)(ii)(IV), and approving termination of the Plan.

Jurisdiction And Venue

2. This Court has jurisdiction to entertain this motion pursuant to 28 U.S.C. §§157 and 1334. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409. Consideration of this motion is a core proceeding pursuant to 28 U.S.C. § 157(b). The statutory predicate for the relief sought herein is Section 363 of the Bankruptcy Code.

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[1] The Debtors are the following entities: Huffy Corporation, Huffy Risk Management, Inc., HUFCO-Ohio, Inc., HCAC, Inc., Hufco-Delaware Company, Huffy Sports, Inc., American Sports Design Company, Huffy Sports Washington, Inc., Huffy Sports Outlet, Inc., Huffy Sports Canada, Inc., Lehigh Avenue Property Holdings, Inc., Tommy Armour Golf Company, Lamar Snowboards, Inc., Huffy Sports Delaware, Inc., First Team Sports, Inc., Hespeler Hockey Holding, Inc., HUFCO-Georgia I, Inc., HUFCO-Georgia II, Inc., HUFCO-New Brunswick, Inc., and HUF Canada, Inc.

Procedural Background

3. The Debtors commenced these cases by the filing of voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") on October 20, 2004 (the "Petition Date"). Pursuant to Federal Rule of Bankruptcy Procedure 1015(b), this Court ordered consolidation of Debtors' Chapter 11 cases to be jointly administered under Case No. 04-39148. Pursuant to Bankruptcy Code Sections 1107(a) and 1108, the Debtors are operating their businesses and managing their affairs as debtors in possession. On November 1, 2004, the Office of the United States trustee appointed a committee of unsecured creditors pursuant to Section 1102(a) of the Bankruptcy Code (the "Unsecured Creditors' Committee"). As of the date hereof, no trustee or examiner has been appointed in any of these Chapter 11 cases.

4. Huffy Corporation ("Huffy") was formed as an Ohio corporation in 1928. Huffy has been a leading distributor of bicycles and other wheeled products. Huffy operates its primary business of selling bicycles through Huffy Bicycle Company, a division of Huffy; its other businesses are operated by numerous subsidiaries. Currently, Huffy has the following subsidiaries in the United States: Huffy Risk Management Inc., Hufco-Ohio, Inc., HCAC, Inc., Hufco-Delaware, Inc., Huffy Sports, Inc., American Sports Design Company, Huffy Sports Delaware, Inc. ("Huffy Sports Delaware"), Hufco-Georgia I, Inc., Lehigh Avenue Property Holdings, Inc., Tommy Armour Golf Company, Lamar Snowboards, Inc., Huffy Sports Washington, Inc., First Team Sports, Inc., Hufco-Georgia II, Inc., Hespeler Hockey Holding, Inc. (collectively, the "U.S. Subsidiaries"). In Canada, Huffy operates its businesses through the following subsidiaries: Huffy Sports Canada Inc. ("Huffy Sports Canada"), Huffy Sports Outlet Inc., HUF Canada, Inc., and Hufco-New Brunswick, Inc. (collectively, the "Canadian

Subsidiaries"). Huffy Sports Canada also owns a Switzerland subsidiary, Huffy Sports Sarl ("Huffy Sarl"), which is not a debtor in these bankruptcy proceedings.

5. Huffy currently manages its affairs at its corporate administrative, sales and marketing offices in Miamisburg, Ohio. Huffy maintains distribution and warehouse facilities in Springboro, Ohio, Carson, California, and Monroe, Ohio. As of the Petition Date, Huffy employed 130 individuals. Huffy's net sales for continuing businesses for the fiscal year ending December 31, 2004 were $188.1 million, and its year-to-date net sales as of April, 2005 were $69.5 million.

6. Huffy has decided to focus its efforts on its core business of bicycles, other wheeled products and golf equipment. It has either sold or discontinued all other non-core business segments. Because of significant liquidity issues and for the reasons otherwise stated herein, Huffy and its subsidiaries filed Chapter 11 petitions for bankruptcy in the United States on the Petition Date. The same day, the Canadian entities filed a request for an ancillary proceeding allowing the Canadian cases to be administered in the United States along with the United States entities.

Notice

7. No trustee or examiner has been appointed in these Chapter 11 cases. Notice of this motion has been given to: (a) the U.S. Trustee; (b) counsel to the Unsecured Creditors' Committee; (c) the PBGC; and (d) the parties that have requested notice in these Chapter 11 cases. In addition, on June 27 and 28, 2005, the Debtors caused a copy of the Notice of the Filing of the Motion and Opportunity to Object to be mailed to the participants and beneficiaries under the Plan. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required.

No Prior Request

8. No prior request for the relief sought in this motion has been made to this or any other court in connection with these Chapter 11 cases.

Relief Requested

9. By this motion, the Debtors seek this Court's approval to terminate the Plan, pursuant to Section 4041 of ERISA. Termination of the Plan is a vital component of the Debtors' reorganization plans, not only saving a significant amount of cash but also allowing the Debtors to attract the necessary sources of liquidity to fund the reorganization. ERISA provides that a pension plan may be terminated if the following "Reorganization Test" is satisfied: "the bankruptcy court (or other such appropriate court) determines that, unless the plan is terminated, such person will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the Chapter 11 reorganization process and approves the termination." 29 U.S.C. § 1341(c)(2)(B)(ii)(IV); 29 C.F.R. § 4041.41(c)(2)(iv); *see also In re Sewell Mfg. Co.*, 195 B.R. 180, 185 (Bankr. N.D. Ga. 1996); *In re Wire Rope Corp. of Am., Inc.*, 287 B.R. 771, 776-77 (Bankr. W.D. Mo. 2002).

Basis For Relief

10. The Plan will be terminated because current financial projections show that Huffy cannot survive past the end of 2005 – and could face liquidation much earlier if sales do not meet forecasts – without a source of additional cash. Huffy cannot obtain additional credit in any material amount, however, so long as its liabilities under the Plan remain in place. This is because the minimum required contributions to the Plan over the next five years – almost $21 million – would consume all of the profits Huffy anticipates earning during that same period, and then some. As a result, based on Huffy's diligent search for a lender or investor, no rational creditor, lender or investor would extend additional credit, or invest in Huffy, so long as the

pension liabilities remain in place. Indeed, Sinosure Group, a group which represents Huffy's suppliers –who are also Huffy's largest group of creditors – during negotiations over a potential Plan of Reorganization ("POR") have insisted upon termination of the Plan as a condition of a proposed Plan of Reorganization providing more lenient trade terms – terms that Huffy desperately needs. Thus, the only path to a successful reorganization – and around a Chapter 7 liquidation – is to obtain this Court's approval of a distress termination of the Plan.

11. On June 16, 2005, Huffy agreed to a term sheet with the Sinosure Group and representatives for the Unsecured Creditors' Committee under which, among other terms, Sinosure Group will receive 30 percent of the reorganized Huffy common stock, with the ability to earn 51 percent ownership by providing 90-day trade terms which would provide Huffy with more than $6 million in additional liquidity. Under this term sheet, Huffy is entitled to 90-day trade terms only if the Plan is terminated prior to the confirmation of the POR. Thus, Huffy has a clear path to reorganization if – but only if – the Plan is terminated.

12. If Huffy cannot reorganize, and must liquidate under Chapter 7, the Plan will be terminated anyway. If the Court approves termination under 29 U.S.C. § 1341{ TA \s "29 U.S.C. § 1341" }, on the other hand, the Pension Benefit Guaranty Corporation ("PBGC") will take over both the assets and liabilities of the Plan, and will continue to pay the retirement benefits due under the Plan in accordance with the insurance program administered by the PBGC. Under that program, more than 99 percent of the participants and beneficiaries will suffer *no loss* in retirement benefits. Of the 3,686 participants and beneficiaries under the Plan, according to calculations by the Plan's actuaries, only 18 vested participants – all current and former management employees of Huffy – stand to suffer any reduction in retirement benefits, and even

those employees may not suffer any reduction depending upon when they retire, and whether the assets of the Plan are sufficient to provide benefits above the PBGC guarantee.[2]

13. In addition to the risk of liquidation, the financial projections also demonstrate that Huffy's current severely curtailed operations (of only 130 employees) simply cannot support the Plan of 3,686 participants or beneficiaries, more than 87 percent of whom were employed in lines of businesses or facilities that no longer exist. Huffy's workforce has shrunk from 6,770 at its peak in 1997, to 130 at present – less than two percent of the number of employees in 1997. The number of participants in the Plan mirrors this reduction. Of the 3,686 participants and beneficiaries, only 77 – or 2 percent – are active employees. Huffy in its current form, thus, cannot afford the enormous pension liabilities of a much larger business that no longer exists.

14. In sum, there is no question that in order for the Debtors to obtain the necessary level of savings to pay their debts, to secure exit financing, and confirm a plan of reorganization that would allow the Company to successfully reorganize, exit bankruptcy and continue in business outside of Chapter 11, the Plan must be terminated.

Request That Order Be Made Immediately Applicable

15. The Debtors request that any order entered approving this motion be made immediately applicable. Bankruptcy Rule 6004(g) provides that "[a]n order authorizing the use, sale or lease or property . . . is stayed until the expiration of 10 days after entry of the order, unless the court orders otherwise." Because the Debtors and the Plan participants require certainty as to the termination of the Plan and due to the number of actions and communications to affected parties, including plan participants and the PBGC that must precede the termination

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2 There are also 12 non-vested participants – current employees with less than five years of service – who would not be subject to the PBGC guarantee. For these non-vested participants, Huffy will shortly file a motion seeking the Court's permission, to pay those employees the lump sum value of their accrued benefit – less than $60,000 in total – out of corporate assets.

and creation of such plans, the Debtors request that any order granting some or all of the relief requested in this motion be made immediately applicable, pursuant to Bankruptcy Rule 6004(g).

WHEREFORE, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto as Exhibit 1: (i) determining that the financial requirements for a voluntary distress termination of the Plan under 29 U.S.C. § 1341(c)(2)(B) are satisfied; (ii) approving the termination of the Plan under 29 U.S.C. § 1341(c)(2)(B) and section 363(b) of the Bankruptcy Code; and (iii) granting such other and further relief as the Court may deem proper.

Dated: July 5, 2005
Cincinnati, Ohio

Respectfully submitted,

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

In re:		
HUFFY CORPORATION	)	Chapter 11
an Ohio corporation, et al.	)	Honorable Lawrence S. Walter
Debtors.	)	
	)	Case Nos. 04-39148 through 04-39167
	)	Jointly Administered

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEBTORS' MOTION FOR AN ORDER DETERMINING THAT DEBTORS MEET THE REQUIREMENTS FOR A DISTRESS TERMINATION OF THE HUFFY CORPORATION RETIREMENT PLAN AND APPROVING TERMINATION OF THE PLAN

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PRELIMINARY STATEMENT

In this motion, Huffy Corporation ("Huffy" or the "Company") and its affiliated debtors and debtors in possession (collectively, the "Debtors") seek an order determining that the Debtors meet the requirements for a "distress termination" of the Huffy Corporation Retirement Plan (the "Plan"), and approving termination of the Plan, pursuant to Section 4041 of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1341. The Debtors seek this relief on the grounds that unless the Plan is terminated, Huffy "will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the Chapter 11 reorganization process." 29 U.S.C. § 1341(c)(2)(B)(ii)(IV).

The question before the Court is not *whether* the Plan will be terminated. It *will* be terminated, one way or another. The only question is whether it will be terminated as part of a Chapter 11 reorganization, allowing Huffy to remain in business, or as part of a Chapter 7 liquidation – resulting in the demise of the last mass-market bicycle distributor still based in the United States, the loss of 130 jobs, and the inability of Huffy's creditors to receive anywhere near the value that they would receive under a successful reorganization.

The Plan *will* be terminated because current financial projections show that Huffy cannot survive past the end of 2005 – and could face liquidation much earlier if sales do not meet forecasts – without a source of additional cash. Huffy cannot obtain additional credit in any material amount, however, so long as its liabilities under the Plan remain in place. This is because the minimum required contributions to the Plan over the next five years, almost $21 million, would consume all of Huffy's free cash flow during that same period – and some $8 million more by current estimates. As a result, based on Huffy's diligent search for a lender or investor, no rational creditor, lender or investor would extend additional credit, or invest in Huffy, so long as the pension liabilities remain in place.

On the other hand, there is a path to a successful reorganization – and around a Chapter 7 liquidation – if this Court approves a distress termination of the Plan. Debtors recently concluded negotiations with the Sinosure Group, a group which represents Huffy's suppliers – who are also Huffy's largest group of creditors – on terms of a potential Plan of Reorganization ("POR"). Under the contemplated POR, the Sinosure Group members would obtain a majority interest in the reorganized company, and would provide 90-day trade terms that would provide Huffy with more than $6 million in additional liquidity. These terms will be available to Huffy, however, only if the Plan is terminated.

If the Court approves termination under 29 U.S.C. § 1341, the Pension Benefit Guaranty Corporation ("PBGC") will take over both the assets and liabilities of the Plan, and will continue to pay the retirement benefits due under the Plan in accordance with the insurance program administered by the PBGC. Under that program, 99 percent of the participants and beneficiaries will suffer *no loss* in retirement benefits. Of the 3,686 participants and beneficiaries under the Plan, according to calculations by the Plan's actuaries, only 18 vested participants – all current or former management employees of Huffy – stand to suffer any potential reduction in benefits, and those reductions will depend on whether the assets of the Plan are sufficient to provide benefits above the PBGC guarantee.[1]

While Huffy regrets the need for termination of the Plan, the alternative options are much worse for all concerned. If the Plan is terminated in Chapter 7, the retired and terminated

1 There are also 12 non-vested participants – current employees with less than five years of service – who would not be subject to the PBGC guarantee. For these non-vested participants, Huffy will shortly file a motion seeking the Court's permission, to pay those employees the lump sum value of their accrued benefit – less than $60,000 in total – out of corporate assets.

participants would do no better under the PBGC guarantees, and Huffy's 130 active employees would suffer both the loss of future pension benefits *and* the loss of employment. Likewise, the PBGC will have the same liabilities no matter how the Plan is terminated, and, if the Plan were terminated in a liquidation, the value of its bankruptcy claim could well be diminished. Finally, the Company's creditors will be substantially better off with an interest in a going concern than with a claim in liquidation.

STATEMENT OF FACTS

A. Background of the U.S. Bicycle Industry.

While the immediate causes of Huffy's current bankruptcy were the failed acquisition of GenX Sports, a Canadian sporting goods company, in 2002, along with low profit returns from several of its product lines, the current motion to terminate the Plan must be viewed in the larger picture of the economics of the U.S. bicycle industry. As explained in more detail below, due to an increase in imports during the last decade, and declining profit margins available from large retail customers who provide increasingly lower prices to consumers, every mass market bicycle retailer in the U.S. has shut down their U.S. operations. (William A. Smith Declaration ("Smith Decl.") ¶ 3.)

1. Increase in Chinese Imports Since 1990 and Reduced Profit Margins.

The U.S. bicycle market was first opened to competition from China in 1990 at about the same time, large retail customers of Huffy and other US bicycle manufacturers placed increased pressure on profit margins on companies like Huffy. Because Chinese bicycle manufacturers have a labor cost advantage over U.S. manufacturers, and because of relatively low import duties imposed by the U.S., by 1996 Chinese manufacturers had obtained approximately 25 percent of the domestic U.S. market. Despite this competition, American manufacturers were still able to hold roughly 50 percent of the domestic market through 1996. (Smith Decl. ¶ 4.)

In 1996, Huffy and the Bicycle Manufacturers Association, a trade group consisting of the major U.S. companies, petitioned the United States International Trade Commission ("ITC") to restrict the import of Chinese bicycles into the U.S. In April 1996, the ITC denied this petition, allowing unlimited access to the U.S. market by low-cost Chinese competition. *See Bicycles from China*, Inv. No. 731-TA-731 (Final), 61 Fed. Reg. 33137 (USITC June 26, 1996).

The combination of open competition from foreign manufacturers, and increasing lower prices and profits margins on bicycles, has made it economically not feasible to manufacture mass-market bicycles in the U.S. As a result, U.S. manufacturers have either shifted more production to China or gone out of business entirely. Since 1996, the number of bicycles manufactured in the U.S. dropped from 8,000,000 to 400,000 as of 2004, while the number of bicycles imported from China has increased from 3,900,000 in 1996 to 18,200,000 in 2004. At the same time, 18 of the 20 bicycle factories in the U.S. as of 1996 have closed or consolidated, with the last one, Raleigh, closing in 2004. Only two high-end specialty manufacturers, Trek and Cannondale, remain in the U.S. They have less than two percent of the domestic market whereas China now manufactures 94 percent of the bicycles imported into the U.S. (Smith Decl. ¶ 5.)

2. The Effect of Chinese Imports and Reduced Profit Margins on Huffy's Operations.

Huffy, headquartered in Miamisburg, Ohio, was founded in Ohio in 1928, and was a leading manufacturer of bicycles and other wheeled products for more than seven decades. At its height in 1997, Huffy had 6,770 employees within the U.S., and operated bicycle manufacturing facilities in Celina, Ohio; Farmington, Missouri; and Southaven, Mississippi. (Smith Decl. ¶ 6.)

Following the ITC's decision in 1996, and the concurrent profit margin pressures from large retain customers, Huffy suffered the same fate as other U.S. manufacturers. The Company closed its Celina plant in 1998, and its Farmington and Southaven plants in 1999. Thus, since 2000 nearly all of Huffy bicycles have been manufactured in China (or, to a small extent, in Taiwan). (Smith Decl. ¶ 7.)

As the result of the closure of these operations, and the sale of various other subsidiaries prior to or as part of the current restructuring,[2] Huffy currently has only limited U.S. operations consisting of its corporate administrative, sales and marketing offices in Miamisburg, Ohio, and its distribution and warehouse facilities in Springboro, Ohio, Carson, California and Monroe, Ohio. It currently employs only 130 salaried employees. (Smith Decl. ¶ 8.)

In summary, Huffy now employs less than two percent of the number of its employees in 1997, but is strapped with a pension plan covering 3,686 participants. (Pat Long Declaration ("Long Decl.") ¶ 4.) As demonstrated below, the Company in its current form simply cannot support the enduring economic burden of a workforce that was 50 times larger only eight years ago.

B. The Huffy Corporation Retirement Plan.

1. Background of the Plan.

The Plan is a single-employer defined benefit plan that was established on October 31, 1952, as the Huffy Salaried Employees' Retirement Plan (the "Salaried Employees Plan"). From 1952 through 1997, the Plan covered only salaried employees of Huffy Corporation and its predecessors. Between 1967 and 1991, Huffy established three other pension plans governing

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2 Since the late-1990s, Huffy has sold various non-core subsidiaries or divisions, including Gerry Baby Products, True Temper Hardware Company, Washington Inventory Services, the Volant® ski business, Gen-X opportunity business, Huffy Service Solutions, and Huffy Sports Company. (O'Malley Decl. ¶ 22.)

different groups of employees – the Plan for Hourly-Rate Employees of Huffy Corporation (the "Bicycle Hourly Plan"), which was established on June 1, 1967; the Plan for Office and Clerical Employees of Huffy Bicycle Division (the "Bicycle Office Plan"), which was established on July 1, 1979; and Huffy Service First, Inc., established the Huffy Service First, Inc. Retirement Plan (the "Service First Plan"), which was established on January 1, 1991. (William P. Bishop Declaration ("Bishop Decl.") ¶ 3.)

On December 31, 1997, the Company merged the Service First Plan into the Salaried Employees Plan, and on December 31, 2000, the Company merged the Bicycle Hourly Plan and the Bicycle Office Plan into the Salaried Employees Plan, creating the Huffy Corporation Retirement Plan as it currently exists.[3] (Bishop Decl. ¶ 5.)

On April 23, 2004, in the face of its existing financial problems, the Company amended the Plan to end future benefit accruals under the Plan – a so-called "plan freeze" – effective June 30, 2004. Thus, no one is currently accruing additional benefits under the Plan (although participants who are not yet vested are entitled to accrue additional "vesting service credit" under the Plan). Implementing the plan freeze also reduced the accrued liability under the Plan by $1,869,717. (Bishop Decl. ¶ 6.)

There are currently 3,686 participants or beneficiaries covered by the Plan, falling into three principal categories: (1) 77 active employees (out of the 130 current employees of Huffy), 65 of whom are vested and 12 of whom are non-vested; (2) 2,701 "vested terminated" employees who have vested benefits under the Plan but who have terminated their employment with Huffy

[3] The Plan at one point also included two other plans, the True Temper Hardware Company Salaried Employees' Retirement Plan (the "True Temper Plan") and the Washington Inventory Service established the W.I.S. Retirement Plan (the "W.I.S. Plan"), covering employees of two subsidiaries of Huffy. With the sale of the assets of True Temper Hardware Company in 1999 and the sale of shares of the Washington Inventory Services in 2000, the Plan's liabilities for accrued benefits of certain participants were assumed by the acquiring entities. (Bishop Decl. ¶ 4.)

and have not yet begun to receive benefits under the Plan; and (3) 908 retirees (including surviving spouses) who are currently receiving retirement benefits under the Plan. (Bishop Decl. ¶ 7.) Of these 3,686 participants or beneficiaries covered by the Plan, more than 87 percent were employed in lines of business or facilities that no longer exist, including 1,815 who were hourly employees at the Celina, Ohio manufacturing plant, which was closed in 1998. (Long Decl. ¶ 3.)

Participants in the Plan are entitled to a monthly benefit upon retirement at age 65 consisting of: (1) 0.90% of "Final Average Monthly Earnings," as defined in the Plan, up to a "Covered Compensation[4]," multiplied by the employee's "Credited Service" (frozen as of June 30, 2004) up to 30 years; (2) 1.30% of Final Average Monthly Earnings *over* Covered Compensation, multiplied by the employee's Credited Service (frozen as of June 30, 2004) up to 30 years; and (3) 0.075% of Final Average Monthly Earnings up to $4,166.67, multiplied by Credited Service (frozen as of June 30, 2004) up to 20 years. Certain management officers as of March 1, 2000, were also entitled to an additional benefit. (Bishop Decl. ¶ 8.)

Under these formulae, the active participants have earned annual benefits ranging from $587 to $59,348, with an average benefit of $8,550. Only two active participants have earned benefits greater than the PBGC guarantee of $45,385.56 at retirement age of 65. (Bishop Decl. ¶ 10.)

[4] Covered compensation for any participant is equal to the annual average (without indexing) of the Taxable Wage Bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the participant attains (or will attain) his Social Security Retirement Age. A 35-year period is used for all participants regardless of the year of birth of the participant. In determining a participant's Covered Compensation for a Year, the Taxable Wage Base for all calendar years beginning after the first day of the Year is assumed to be the same as the Taxable Wage Base in effect as of the beginning after the 35-year period described above is the participant's Covered Compensation for the Year during which the 35-year period ends. A participant's Covered Compensation for a Year beginning before the 35-year period described above is the Taxable Wage Base in effect as of the beginning of the Year. (Bishop Decl. ¶ 9.)

2. The Company's Funding Obligations Under the Plan.

As of January 1, 2005, the Plan had assets with a market value of $72,171,000, and the present value of accumulated benefits calculated on a pension termination basis was $135.4 million.[5] (Bishop Decl. ¶ 11.) The Plan's actuaries have also estimated that under the minimum funding requirements of ERISA and the Internal Revenue Code – which require that plans be funded at a much more conservative interest rate assumption – the Company will be required to contribute $20,751,000 to the Plan between 2007 and 2010. *See* ERISA § 302, 29 U.S.C. § 1082; IRC § 412 (identical provisions that set out detailed rules on when and how much, a plan sponsor must contribute to its defined benefit plan each year). In March 2005, the Company reviewed these projections with the PBGC, and the PBGC has concurred with the Company's evaluation. (Bishop Decl. ¶ 12.)

As illustrated in the following chart, these payments will first become due on April 15, 2007, and will continue on a quarterly basis through September 15, 2010.[6] (Bishop Decl. ¶ 13)

5 The value of accumulated benefits may be calculated using different interest rate assumptions depending on the purpose of the calculation. In calculating the accrued value of benefits on a plan termination basis, the interest rate assumption is based on the projected cost of purchasing annuities to cover all plan liabilities at the time of termination. Specifically, here, the $135.4 million – accrued value of benefits on a plan termination basis, was calculated based on PBGC annuity rates as of July, 2005 (3.60% for 2005-2024, 4.75% thereafter) and estimated participant data as of January 1, 2005. The value of accumulated benefits calculated on an on-going plan basis was $69,313,000 as of January 1, 2005. (Bishop Decl. ¶ 11.) While the issue is not currently before the Court, Huffy submits that under Sixth Circuit authority, the appropriate calculation for determining the value of any PBGC claim arising out of termination would be calculated based on the prudent investment standard.

6 The totals do not add in certain columns due to rounding.

Quarterly Payments in Thousands from 2007 to 2010

	2007	2008	2009	2010	TOTAL
Jan. 15	--	2,038	1,320	943	N/A
April 15	2,038	1,321	943	--	N/A
July 15	2,038	1,321	943	--	N/A
Sept.15	2,038	1,657	1,100	786	N/A
Oct. 15	--	1,321	944	--	N/A
TOTAL	6,114	7,657	5,251	1,729	20,751

While the projected payments will not begin for roughly 21 months, for the reasons explained below, the existence of a $20,751,000 liability will prevent Huffy from obtaining the additional credit it needs in the short term to survive, and would prohibit Huffy from implementing a successful reorganization. (O'Malley Decl. ¶ 3.)

3. The Effect of Termination on Existing Benefits.

Under Title IV of ERISA, upon termination of a defined benefit plan pursuant to 29 U.S.C. §4041, the PBGC insures the benefits due under the plan up to a statutorily determined level depending on the age at which the participant begins drawing benefits. For plan terminations in 2005, the PBGC guarantee for the Plan participants who begin drawing benefits at age 65 is $3,782.13 per month, or $45,385.56 per year. This benefit is reduced, proportionately, for participants who begin drawing retirement benefits before age 65, as well as for participants who elect to receive an optional form of benefit (e.g., a joint & survivor annuity). (Bishop Decl. ¶ 14.)

The Plan's actuaries have calculated that of the 3,686 vested participants and beneficiaries in the Plan, more than 99 percent will suffer *no* reduction in benefits because the amount of benefits to which they are entitled under the Plan is less than the PBGC guarantee regardless of the age at which they retire. According to estimates by the Plan's actuaries, there are only 18 vested participants or beneficiaries, all of whom are current or former management employees (except for one alternate payee pursuant to a qualified domestic relations order), who stand to suffer any reduction. Seven of these participants and beneficiaries (including the alternate payee) are already in payment status, and the payment they are currently drawing exceeds the PBGC guarantee based on their retirement age. For the remainder, the PBGC guarantee will depend on the employee's age at retirement, and only two of these active participants would see any reduced benefit at normal retirement age. (Bishop Decl. ¶ 15.)

Moreover, the PBGC's so-called "maximum benefit" is actually a "minimum" that the PBGC guarantees that the participant will receive regardless of plan assets. If the Plan's assets as of the termination date are sufficient to pay a higher benefit than the guarantee, the PBGC will pay the higher amount. Such payments, if possible, are allocated through a priority system under which participants who are retired, or within three years of retirement age, receive priority for the higher payment. Eight of the 18 potentially-affected vested participants are in the highest priority category, known as PC3, who will receive priority for the higher benefit if sufficient assets are available. (Bishop Decl. ¶ 16.)

There are also 12 active employees who are not yet vested under the Plan because they do not have five years of service. Because the PBGC does not guarantee benefits for non-vested participants, these employees would lose their accrued benefits under Plan. (Bishop Decl. ¶ 17.)

C. The Financial Necessity for Termination of the Plan.

1. The Required Contributions to the Plan During 2005-2010 Will Far Exceed Huffy's Estimated Free Cash Flow During the Same Period.

Huffy's estimated funding obligations of almost $21 million during 2005-2010 will far exceed its projected free cash flow (or any other metrics of profitability) during the same period.

Given these projections, it is also indisputable that Huffy cannot survive without terminating the Plan. (O'Malley Decl. ¶ 3.)

While there are various ways to estimate whether a debtor can survive with its existing pension obligations, and there is always a range of reasonable projections for costs and revenue, there is no credible scenario under which Huffy can survive without termination of the Plan. One of the most accurate ways to predict future financial wherewithal is "free cash flow," which captures a company's net cash flow by taking the net income before depreciation and amortization and deducting capital expenditures and excluding non-cash charges. The following chart shows Huffy's projected free cash flow from 2005-2010 prepared on a basis consistent with the proposed plan of reorganization (further discussed below), adjusted for the impact of pension expense and funding.[7] (O'Malley Decl. ¶ 4.)

7 The underlying assumptions for the proposed plan of reorganization are inconsistent with the pro forma computations shown in this chart, as the 90 trade terms (discussed below) would not be available to Huffy if the Plan was not terminated. (O'Malley Decl. ¶ 4 n. 2.)

Cash Flow from 2005-2010 (amounts in millions)

	2005	2006	2007	2008	2009	2010	Total
Net Income	34.2	1.2	2.4	3.6	4.5	5.5	51.4
Adjustment for non-cash charges:							
Restructuring charges	(47.6)	-	-	-	-	-	(47.6)
Depreciation	0.9	0.6	0.7	0.7	0.7	0.7	4.3
Non-cash pension expense[8]	2.4	2.3	2.1	1.2	0.5	(0.1)	8.4
Less: Capital Expenditures	(0.6)	(0.7)	(0.8)	(0.8)	(0.8)	(0.8)	(4.5)
Free Cash Flow	**(10.7)**	**3.4**	**4.4**	**4.7**	**4.9**	**5.3**	**12.0**
Pension Funding	-	-	6.1	7.7	5.3	1.7	20.8
Shortfall	**(10.7)**	**3.4**	**(1.7)**	**(3.0)**	**(0.4)**	**3.6**	**(8.8)**

As this chart demonstrates, if the Plan is not terminated, there would be a shortfall of over $8 million during the period from 2005 to 2010. If the Plan were terminated, on the other hand, Huffy is projected to have a positive cash flow during the same period – allowing it to reorganize, and remain in business. (O'Malley Decl. ¶ 5.)

2. Huffy Cannot Obtain Additional Credit or Investment Without Eliminating Its Liability Under the Plan, and Without a New Source of Liquidity, Huffy Will Run Out of Cash in 2005.

While the future viability of Huffy is threatened by pension plan funding obligations beginning in 2007, Huffy faces a much more immediate cash crisis that, like its long-term problems, cannot be resolved without termination of the Plan. As explained below, Huffy is perilously close to running out of cash, and it cannot obtain additional liquidity so long as the pension obligations remain in place. (O'Malley Decl. ¶ 6.)

8 Non-cash pension expense is the "accounting entry" required by GAAP to account for the increase in the pension liability in each year regardless of when payments are due. This expense is not directly related to the quarterly pension funding requirements.

2 The underlying assumptions for the proposed plan of reorganization are inconsistent with the pro forma computations shown above as 90 trade terms would not be available to Huffy if the pension plan was not terminated.

As the Court is aware, at the outset of the Chapter 11 case Huffy obtained a $50 million post-petition credit facility from Congress Financial Corporation ("Congress") that was approved by the Court by final order entered on November 30, 2004. In March 2005, Huffy negotiated an amendment to the DIP Facility that, among other things, provided Huffy with access to a portion of the proceeds from the sale of non-core assets and modified certain covenants to decrease the risk of a default. (O'Malley Decl. ¶ 7.)

In June 2005, Huffy negotiated a second amendment to the DIP Facility that, among other things, provided Huffy with an additional $2.5 million of liquidity and further modified certain covenants to decrease the risk of default. Under this facility, the availability of additional borrowings while in bankruptcy are based on a combination of the collateral value of accounts receivable and inventory. Huffy's borrowings are limited to 85 percent of its accounts receivable, less certain ineligible receivables, and 50 to 66 percent of its inventory, less certain ineligible inventory, less a collateral block and reserves for reorganization costs. The following chart shows Huffy's anticipated borrowing available under this facility, and its anticipated draws upon this facility, through January 2006. (O'Malley Decl. ¶ 8.)

Monthly Revolver Availability (amounts in millions)

	July 2005	**Aug 2005**	**Sept 2005**	**Oct 2005**	**Nov 2005**	**Dec 2005**	**Jan 2006**
Accounts Receivable Borrowing Base	18.9	21.6	28.0	30.6	31.3	22.8	11.6
Inventory Borrowing Base	18.9	18.3	17.9	17.2	14.0	10.6	18.6
Total Borrowing Base	32.4	34.5	40.5	42.5	39.8	28.0	24.8
Revolver Borrowing	25.4	27.9	34.1	35.2	36.2	34.0	25.3
Total Line Usage	31.7	34.3	40.5	41.6	42.6	40.4	31.7
Excess Availability	**$0.6**	**$0.2**	**$0.0**	**$0.9**	**$(2.8)**	**$(12.4)**	**$(7.0)**

As this chart illustrates, assuming that Huffy stays in bankruptcy, without a further source of liquidity Huffy will be out of cash – and out of business – by November 2005 because, at that point, Huffy's cash requirements will exceed its available borrowings by $2.8 million. By December 2005 , if Huffy were still in business, its cash requirements would exceed its available borrowings by $12.4 million. (O'Malley Decl. ¶ 9.)

Huffy's ongoing cash requirements are roughly $5 million per week. From July 2005 through October 2005, on the other hand, Huffy's available borrowings are anticipated to be in the range of nil to $900,000. If Huffy were to experience only a minimal decline in sales, or a minimal delay in inventory or cash collections, it would not have sufficient liquidity to pay its obligations in the normal course. A company Huffy's size should have at least $5 million in cash and accessible credit – and preferably more – to create a reasonable cushion against potential shortfalls from projections and to allow for seasonal demands in working capital. (O'Malley Decl. ¶ 10.)

In summary, under the status quo – that is, Huffy's reasonably anticipated profits and Huffy's currently available cash and credit – the Company will be out of business by November 2005, if not earlier, if the Plan is not terminated. Both before and after filing for bankruptcy, Huffy has been actively seeking sources of additional liquidity for both its ongoing operations and its planned reorganization. It has become clear, however, that no significant additional credit will become available so long as the Company's pension obligations exceed its projected profit through at least 2010. (O'Malley Decl. ¶ 11.)

3. Huffy Has Reached Agreement With Its Creditors on the Terms of a Potential Plan of Reorganization That Will Provide It With Sufficient Liquidity if – and Only if – the Court Approves Plan Termination.

Because Huffy cannot adequately access the traditional capital markets, Huffy has focused its efforts on obtaining an agreement with the Sinosure Group – the representative of its

Chinese bicycle suppliers, who are also the largest single group of creditors – on a proposed Plan of Reorganization ("POR") that will provide Huffy with more liberal trade terms that will provide sufficient liquidity to remain in business. (O'Malley Decl. ¶ 12.)

Huffy currently has 60-day trade terms from the Sinosure Group, meaning that payment must be made within 60 days after delivery of the bicycles in China for transport to the U.S. Since February 2005, Huffy has been in negotiations with the Sinosure Group on a proposed POR in which the Sinosure Group suppliers would obtain a controlling interest in the reorganized Company, and, in return would provide Huffy with 90-day trade terms among other provisions. The 90-day trade terms would provide Huffy with more than $6 million in additional liquidity. Throughout these negotiations, however, the Sinosure Group has continually declined to provide the 90-day payment terms if the Plan obligations remain in place. (O'Malley Decl. ¶ 13.)

On June 16, 2005, after months of negotiations, Huffy was able to reach agreement with the Sinosure Group on a proposed POR under which, among other terms, the Sinosure Group members will receive 30 percent of the reorganized Huffy common stock, with the ability to earn 51 percent ownership by providing 90-day trade terms over a term of five years. Under the term sheet, Huffy is entitled to 90-day trade terms only if the Plan is terminated prior to the confirmation of the POR. Moreover, Huffy believes that the POR provides the best possible recovery for its creditors that there are no other viable alternatives that would allow the Plan to continue. Thus, Huffy now has a clear path to reorganization if – but only if – the Plan is terminated. (O'Malley Decl. ¶ 14.)

Huffy and its advisers have concluded that there are no other viable options for reorganizing that would not also require Plan termination. First, Huffy diligently sought to find suppliers who would provide more lenient trade terms without this condition but was unsuccessful in doing so. To the contrary, other potential suppliers have insisted on more onerous trade terms than those the Sinosure Group is willing to provide under the proposed POR. (Smith Decl. ¶ 9; O'Malley Decl. ¶ 15.)

Second, Huffy and its advisors have had discussions with a number of potential lenders and investors regarding additional financing or investment upon exit from bankruptcy, and it has become clear that no one will lend or invest at a significant level without termination of the Plan. On April 6, 2005, the Debtors filed a motion for approval of the fees of potential replacement lenders to allow the additional due diligence to be performed. While Huffy will be diligent in attempting to obtain as much financing on as favorable terms as possible, it is highly unlikely that the Company will obtain financing to provide sufficient liquidity to effectuate a plan of reorganization without termination of the Plan. (O'Malley Decl. ¶ 16.)

D. The Debtors Have Exhausted Other Means to Increase Revenue, and Cut Costs, in Order to Avoid Termination of the Plan.

1. There Are No Alternatives to Termination That Would Sufficiently Reduce the Pension Costs.

One factor that the Court may want to consider in a case of this sort is whether there are alternatives short of termination that would achieve sufficient savings to allow reorganization. In the present case, however, it is clear that nothing short of a termination of the Plan would provide sufficient financial relief for Huffy to successfully reorganize.

Huffy has already taken the most obvious alternative, which is freezing the Plan. Even with the elimination of future accruals since June 30, 2004, the Plan still faces funding obligations that exceed the Company's projected free cash flow by in excess of $8 million over the next five years. (O'Malley Decl. ¶ 17.)

Second, the Company also pursued more innovative funding methods with the PBGC, including changing the accounting methods in determining the plan contributions, allowing Huffy to apply for the Internal Revenue Service ("IRS") waiver prior to 2008 and other possible solutions not explicitly provided under ERISA or the Internal Revenue Code. (O'Malley Decl. ¶ 20.)

Third, the potential availability of an IRS waiver of the Company's minimum funding obligations would not provide meaningful relief. IRS procedures do not allow an applicant to submit a request for a waiver until the close of the year in which the deficiency occurs. Because the Plan will not incur a deficiency until the end of the 2007 plan year, Huffy cannot apply for an IRS waiver until 2008. (Bishop Decl. ¶ 18.) Without relief from the existing obligations, Huffy will cease existing before 2008. (O'Malley Decl. ¶ 18.)

Finally, even if one could count on the availability of an IRS waiver, a waiver simply defers the payment to subsequent years, and does not eliminate the underlying liability or Huffy's inability to fund the payments. (Bishop Decl. ¶ 19.) As explained below, without a reduction in the underlying liability, Huffy will not be able to reorganize, and will face liquidation in short order. (O'Malley Decl. ¶ 19.)

2. Huffy Has Already Made Considerable Efforts to Cut Costs and Preserve Liquidity in Other Areas.

As the Court is aware from prior proceedings, Huffy has not latched onto pension plan termination as the panacea for its financial troubles (and that alone would not be a panacea). Since the outset of these reorganization cases, Huffy has engaged in a variety of activities to preserve and enhance liquidity. As noted above, Huffy was successful at the outset of this case in obtaining a $50 million post-petition credit facility, and negotiated amendments to that facility in March and June 2005 that provide, among other things, reduction in collateral reserves and modifies certain covenants to decrease the risk of a default. Huffy was also successful in obtaining trade terms of 60-days on post-petition purchases of inventory from a majority of Huffy's suppliers, providing up to an additional $20 million in liquidity. (O'Malley Decl. ¶ 21.)

Huffy also reviewed its assets in an effort to identify and sell non-strategic assets. As a result of this process, a number of assets have been sold during the course of these cases. The aggregate proceeds received from these asset sales of Huffy's non-essential business lines were approximately $6 million. (O'Malley Decl. ¶ 22.)

Since the inception of this case, Huffy has also been engaged in an extensive cost reduction program encompassing all its operations. For example, Huffy has reduced the number of warehouses and offices utilized in its operations by closing or selling three of its warehouses in Minnesota, the Netherlands and Toronto, as well as its offices in Toronto. Huffy has also rejected the leases of three more warehouses, and has consolidated its Springboro and Miamisburg, Ohio office locations in June 2005. The Company is also currently studying additional cost reductions. (O'Malley Decl. ¶ 23.)

Finally, Huffy has obtained significant cost savings at the expense of the few remaining active employees. First, Huffy restructured the organization of its operating entities from separate business units with general management, sales, marketing and logistics functions and administration requiring a staff of 525 in 2003, down to a single operating unit with one management, sales, marketing and logistics function and administration – reducing its staff to 170 as of September 2004. Huffy has further reduced its total employees to 130 as of June 2005. (O'Malley Decl. ¶ 24.)

For the few remaining employees, Huffy has implemented a variety of other labor cost saving measures, including, but not limited to, a 12-month salary freeze, elimination of a 401(k) match and 2 percent deferred compensation, suspension of a tuition reimbursement plan, elimination of the Company-sponsored physical program, elimination of non-essential employee training programs and elimination of Huffy Foundation contributions. Despite these measures, voluntary attrition remains low, and the employees are focused and motivated to achieve a successful reorganization. (O'Malley Decl. ¶ 25.)

E. The Debtors Have Fulfilled the Procedural Requirements for Plan Termination.

While the narrow issue before this Court is whether the Debtors meet the financial standard for a distress termination, the Court should be aware that Huffy has also been pursuing discussions with the PBGC, and has implemented the procedural requirements for a distress termination. (O'Malley Decl. ¶ 26.)

Huffy and its advisors first met with the PBGC on March 2, 2005, to discuss Huffy's financial status, including its upcoming funding obligations, possible alternatives to termination of the Plan, and the potential need to terminate the Plan. Following that meeting, Huffy and the PBGC continued to engage in discussions and exchanged various financial information. By March 14, 2005, the PBGC agreed with the Huffy's funding projections for the next five years. (O'Malley Decl. ¶ 27.)

In mid-April, 2005, Huffy and the PBGC held another conference telephone call to further discuss the Company's options. (O'Malley Decl. ¶ 28.)

On June 27, 2005, Huffy sent out notices of intent to terminate ("NOIT") required by ERISA, 29 U.S.C. § 1341(a)(2), setting forth the proposed pension termination date of August 31, 2005. With each NOIT, Huffy included separate cover letters to each participant or beneficiary explaining whether they would or would not likely see any reduction in their benefits.[9] (O'Malley Decl. ¶ 29.)

ARGUMENT

Title IV of ERISA, 29 U.S.C. § 1301, *et seq.*, provides that an employer may seek to terminate a single-employer defined benefit plan under specific circumstances, and that in the event of termination the PBGC will guarantee the benefits under the plan up to certain levels. *See generally Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 446 (1999); *PBGC v. Mize Co.*, 987 F.2d 1059, 1061 (4th Cir. 1993). Under 29 U.S.C. § 1341(c), where the employer is operating under Chapter 11, the employer may terminate a plan if it "will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the Chapter 11 reorganization process." 29 U.S.C. § 1341(c)(2)(B)(ii)(IV) . Under this provision, the courts have held that the determinative test is whether the debtor can get out of bankruptcy, and stay out, without terminating the pension plan. *See In re Wire Rope Corp. of Am., Inc.*, 287 B.R. 771, 776-77 (Bankr. W.D. Mo. 2002); *In re Sewell Mfg. Co.*, 195 B.R. 180, 185 (Bankr. N.D. Ga. 1996).

In the present case, Debtors submit that they clearly satisfy this standard, and the Court should make both the necessary factual findings and approve termination of the Plan. If the Court does not do so, Huffy will run out of cash by the end of 2005, if not earlier, and will face liquidation under Chapter 7.

This situation clearly satisfies the applicable legal standard. In the existing case law, the courts have focused on whether the debtors could secure exit financing and submit a confirmable

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9 In addition, on June 27 and 28, 2005, the Debtors caused a copy of the Notice of the Filing of the Motion and Opportunity to Object to be mailed or delivered to the participants and beneficiaries under the Plan. (Helana Darrow Declaration ("Darrow Decl.") ¶ 3.)

plan of reorganization without termination of the pension plan. Thus, the test is functionally equivalent to the well-recognized "feasibility" standard for confirmation of a plan of reorganization under Section 1129(a)(11) of the Bankruptcy Code. Courts have consistently found that a reorganization plan generally is not feasible without adequate financing. *See, e.g.*, *In re Monnier Bros.*, 755 F.2d 1336, 1341 (8th Cir. 1985) (quoting *United Props., Inc. v. Emporium Dep't Stores, Inc.*, 379 F.2d 55, 64 (8th Cir. 1967)) (stating that "in determining whether [a plan] is feasible, the bankruptcy court has an obligation to scrutinize the plan carefully to determine whether it offers a reasonable prospect of success and is workable"); *In re P.J. Keating Co.*, 168 B.R. 464, 471 (Bankr. D. Mass. 1994) (finding plan of reorganization not feasible where fixed expenses too high and likelihood that Debtor will eventually be liquidated); *In re Northeast Family Eyecare, P.C.*, No. 01-13983DWS, 2002 WL 1836307, at *5 (Bankr. E.D. Pa. July 22, 2002) (concluding that a proposed plan was not feasible given the court's doubt that the debtor could secure a timely capital infusion); *In re Atrium High Point Ltd. P'ship*, 189 B.R. 599, 609-10 (Bankr. M.D.N.C. 1995) (discussing the unlikelihood that the debtor will be able to find sufficient financing to make payment due under proposed plan as a factor weighing against a finding of plan feasibility); *In re Hickey Props, Ltd.*, 181 B.R. 173, 174 (Bankr. D. Vt. 1995) (denying confirmation of plan due to finding that the debtor "will be unable to obtain the funds necessary to implement its Plan"); *In re Tyler*, 156 B.R. 995, 997 (Bankr. N.D. Ohio 1993) ("At the point of confirmation, th[e] source of funding must be shown to be firm as it goes directly to feasibility. . . . Without evidence of a firm commitment of financing, this Plan does not meet the feasibility requirement.") (citation omitted).

If constructing a confirmable plan requires that the debtor terminate its pension obligations, then the ERISA standard has been met. *See In re Wire Rope Corp.*, 287 B.R. at 777-

78 ("If the Debtor cannot obtain confirmation of a plan of reorganization in the first instance, then it clearly cannot pay its debts under a plan of reorganization, and the Court's approval of a distress termination of the Retirement Plans would be warranted"); *In re Sewell*, 195 BR. at 185-86) (reorganization distress test met where debtors unable to find a buyer or lender to finance the plan obligations); *In re US Airways Group, Inc.*, 296 B.R. 734, 743-46 (Bankr. E.D. Va. 2003) (finding that ERISA test had been satisfied where the only realistic plan of reorganization required termination of defined benefit plan).

Under this test, if the debtor requires savings from the termination of its pension plan to satisfy the financial projections for exit financing and provide "comfort" to those lenders that the debtor can execute its business plan and projections, the voluntary distress termination standard has been met. *US Airways*, 296 B.R. at 745-46 (holding the distress termination standard met where the debtor's ability to obtain exit financing necessary for plan of reorganization was "dependent on the debtor's ability – and more precisely on the [exit financiers'] comfort that the debtors have the ability – to meet in each year the levels of profitability reflected in the seven-year business plan"); *In re Wire Rope Corp.*, 287 B.R. at 778-79 (approving termination where debtor otherwise would not be able to obtain debt and equity financing necessary to confirm a plan and continue in business outside of Chapter 11).

The present case, on the other hand, involves circumstances much more serious than providing "comfort" to potential lenders and investors. Here, as explained above, there is a serious risk that Huffy's existing shortage of cash and limited credit puts it in jeopardy of liquidation in the short term, and it is clear that potential lenders and investors will be, and are, unwilling to extend credit unless the Plan is terminated. On the other hand, if the Court approves termination, and if the potential POR (contemplated under the term sheet with the Sinosure Group) is approved, Huffy has a strong chance of successfully reorganizing.

CONCLUSION

For all the foregoing reasons, the Debtors respectfully request that this Court find that the requirements for a voluntary distress termination have been satisfied, and approve the termination of the Plan.

Dated: July 5, 2005
Cincinnati, Ohio

Respectfully submitted,

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

In re:	)	Honorable Lawrence S. Walter
	)	
HUFFY CORPORATION, an Ohio corporation, et al.,	)	Case Nos. 04-39148 through 39167 Chapter 11
	)	
Debtors.	)	Jointly Administered

RESPONSE OF THE PENSION BENEFIT GUARANTY CORPORATION TO DEBTORS' MOTION FOR AN ORDER DETERMINING THAT DEBTORS MEET THE REQUIREMENTS FOR A DISTRESS TERMINATION OF THE HUFFY CORPORATION RETIREMENT PLAN AND APPROVING TERMINATION OF THE PLAN

PRELIMINARY STATEMENT

The Pension Benefit Guaranty Corporation ("PBGC"), the federal agency charged with administering the pension plan termination provisions of Title IV of the Employee Retirement Income Security Act of 1974, *as amended* ("ERISA"), 29 U.S.C. §§ 1301-1461 (2000 & Supp. II 2002), responds to the Debtors' motion asking this Court to determine that Huffy Corporation ("Huffy") and its debtor affiliates (collectively the "Debtors")[1] meet the requirements for a "distress termination" of the Huffy Corporation Retirement Plan (the "Pension Plan") under the "reorganization in bankruptcy" test set forth in 29 U.S.C. § 1341(c)(2)(B)(ii)(IV), and approve the termination of the Pension Plan (the "Distress Motion").

[1] The Debtors are Huffy Corporation, Huffy Risk Management, Inc., HUFCO-Ohio, Inc., HCAC, Inc., Hufco-Delaware Company, Huffy Sports, Inc., American Sports Design Company, Huffy Sports Washington, Inc., Huffy Sports Outlet, Inc., Huffy Sports Canada, Inc., Lehigh Avenue Property Holdings, Inc., Tommy Armour Golf Company, Lamar Snowboards, Inc., Huffy Sports Delaware, Inc., First Team Sports, Inc., Hespeler Hockey Holding, Inc., HUFCO-Georgia I, Inc., HUFCO-Georgia II, Inc., HUFCO-New Brunswick, Inc., and HUF Canada, Inc.

PBGC, a party in interest and unsecured creditor in this proceeding, files this initial Response to advise the Court of the agency's views on the proper legal standards for determining whether the Debtors meet the "reorganization in bankruptcy" distress test for the Pension Plan, and to urge the Court to carefully review the evidence the Debtors present in support of their Motion. As the agency charged with administering the distress termination provisions of Title IV of ERISA, PBGC believes its views on the correct interpretation of the statute are entitled to considerable weight and will help inform the Court's consideration of this critically important issue. *See PBGC v. LTV Corp.*, 496 U.S. 633, 647-48 (1990), *citing Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984); *see also PBGC v. Republic Tech. Int'l, LLC,* 386 F.3d 659, 668 (6th Cir. 2004), *cert. denied sub nom. United Steelworkers of Am. v. PBGC*, 125 S.Ct. 1594 (2005); *cf. United States v. Mead*, 533 U.S. 218 (2001); *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944) (agency's views on legal issues entitled to respect based on "power to persuade").

Under ERISA, a bankruptcy court's role in the distress termination process under the "reorganization in bankruptcy" test is limited to determining whether a debtor "will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process" unless a pension plan is terminated. 29 U.S.C. § 1341(c)(2)(B)(ii)(IV); 29 C.F.R. § 4041.41(c)(2)(iv) (2004); *In re Philip Servs. Corp.*, 310 B.R. 802, 807 (Bankr. S.D. Tex. 2004); *In re Wire Rope Corp. of Am., Inc.*, 287 B.R. 771, 777 (Bankr. W.D. Mo. 2002). ERISA imposes a rigorous test of last resort that requires the employer to prove that *but for* the termination of the pension plan, the employer's business will be liquidated. *In re US Airways Group, Inc.*, 296 B.R. 734, 743 (Bankr. E.D. Va. 2003). Thus, an employer must demonstrate that it has pursued and exhausted *all* realistic measures short of termination that would make funding and maintaining the pension plan affordable, such as obtaining minimum funding waivers or freezing future accruals of benefits under the pension plan, cutting non-pension expenditures such as payroll, capital acquisitions and overhead so that more cash flow will be available to satisfy pension funding requirements, or finding an investor or lender who will finance the employer while it continues to fund and maintain the plan. The rigorous nature of the distress test makes it especially important that this motion be decided on a fully developed record.

If the Debtors are to support their assertion that the Pension Plan is unaffordable because the minimum required contributions "consume all of the profits Huffy anticipates earning during that same period . . .," Distress Motion ¶ 10, they must demonstrate that they do in fact have a realistic and developed business plan that is based on credible and detailed financial projections. We are still reviewing the details of the Debtors' projections that support their business plan, and are evaluating whether there is sufficient free cash flow to support the Pension Plan. Additionally, the Debtors assert that they diligently searched for lenders and investors, but claim that "no rational creditor, lender or investor would extend additional credit, or invest in Huffy, so long as the pension liabilities remain in place." Distress Motion ¶ 10. PBGC has not yet received sufficient proof that the Debtors actively marketed Huffy seeking potential equity investors, and what, if any, conditions precedent exist for potential lenders or investors to extend additional credit or inject needed capital. Until Debtors (who have the burden of proof) come forward with a fully developed business plan that is based on credible and complete financial projections and other financial information, PBGC believes that judicial resolution of the "reorganization in bankruptcy" distress test is premature.[2]

THE PBGC AND THE PENSION PLAN

PBGC is a wholly-owned United States government corporation that administers the defined benefit pension plan termination insurance program established under Title IV of ERISA. When an underfunded plan is terminated, PBGC generally becomes trustee of the plan and, subject to certain statutory limitations, pays the plan's unfunded benefits from PBGC's insurance funds. *See* 29 U.S.C. § 1322.

On October 20, 2004, the Debtors filed voluntary petitions under Chapter 11 of the Bankruptcy Code. Huffy established and maintains the Pension Plan to provide pension benefits for certain of its current and former employees. The Pension Plan is covered by Title IV of ERISA, 29 U.S.C. §§ 1301-1461. Huffy is the contributing sponsor of the Pension Plan. 29 U.S.C. § 1301(a)(13).

If the Pension Plan terminates, the Debtors and each trade or business under common control with the Debtors[3] would be jointly and severally liable to PBGC for the amount of the unfunded benefit liabilities of the Pension Plan ("Unfunded Benefit Liabilities"). 29 U.S.C.

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[2] PBGC is in the process of obtaining and evaluating information from the Debtors and others, through discovery and consensual exchange, on the specifics of these issues. PBGC hopes to be in a better position to advise the Court of its views on the affordability of the Pension Plan, once this information exchange is completed and after the Debtors have presented more detailed financial projections and explained their financial case.

[3] A group of trades or businesses under common control, referred to as a "controlled group," includes, for example, a parent and its 80-percent owned subsidiaries. 29 U.S.C. § 1301(a)(14); 29 C.F.R. 4001.3; 26 U.S.C. §§ 414(b),(c); Treas. Reg. § 1.414(b)-1, (c)-2. Huffy, its debtor affiliates, and Huffy Sarl, a non-debtor affiliate, are members of the Huffy's controlled group.

§ 1362(b). In addition, the Debtors and each controlled group member would be jointly and severally liable to PBGC, as statutory trustee of the Pension Plan, for contributions required under the minimum funding standards of ERISA and the Internal Revenue Code ("I.R.C." ("Minimum Funding Contributions") up to the Pension Plan's termination date. *See* 29 U.S.C. §§ 1082(c)(11), 1362(c); I.R.C. § 412(c)(11); Rev. Rul. 79-237, 1979-2 C.B. 190. Further, the Debtors and each controlled group member are jointly and severally liable for insurance premiums ("Premiums") due the PBGC under 29 U.S.C. § 1307.

PBGC estimates that the amount of the Unfunded Benefit Liabilities is $68,100,000, and that the amount of unpaid Premiums is $32,772, and has filed claims in those amounts. PBGC filed an unliquidated claim for unpaid Minimum Funding Contributions. According to the Debtors' estimates, the Pension Plan will not require any minimum funding contributions until at least 2007. Memorandum of Points and Authorities in Support of the Distress Motion at 8. PBGC intends to amend these claims to reflect any updated estimates.

On or about June 29, 2005, Huffy filed with PBGC a notice to terminate the Pension Plan in a distress termination and to establish August 31, 2005, as the Pension Plan's termination date. As part of the distress termination process, Debtors have filed the current motion with the Court asking it to determine that each of the Debtors meets the "reorganization in bankruptcy" distress test, 29 U.S.C. § 1341(c)(2)(B)(ii)(IV).

THE DISTRESS TERMINATION TESTS UNDER ERISA

Title IV of ERISA provides the exclusive means for terminating a defined benefit pension plan. *See* 29 U.S.C. § 1341(a)(1); *Hughes Aircraft Co. v. Jacobsen*, 525 U.S. 432, 446 (1999); *see also Philip Servs.*, 310 B.R. at 806, 808-09. To proceed with a distress termination, Huffy, as the sponsor of the Pension Plan, and each member of its controlled group must satisfy one of the four statutory distress termination tests under 29 U.S.C. § 1341(c)(2)(B). These tests are: (a) liquidation in bankruptcy; (b) reorganization in bankruptcy; (c) inability to pay debts when due; and (d) unreasonably burdensome pension costs. *Id. See also,* 29 C.F.R. § 4041.41(c).

Under the "reorganization test," ERISA requires a debtor to make a showing that it will be unable to pay all of its debts under a plan of reorganization and will be unable to continue in business outside of Chapter 11. 29 U.S.C. § 1341(c)(2)(B)(ii)(IV). Under the distress termination provisions, a pension plan may terminate only if: (1) the plan administrator provides affected parties, including PBGC and plan participants, at least 60-day advance written notice of its intent to voluntarily terminate the pension plan, as required under 29 U.S.C. § 1341(a)(2); (2) the plan administrator provides PBGC with the information set forth in 29 U.S.C. § 1341(c)(2)(A); and (3) PBGC makes certain determinations based upon the required disclosures.[4] 29 U.S.C. §§ 1341(c)(1)(A), (B).

Congress carefully considered how these new ERISA provisions should operate in a Chapter 11 bankruptcy proceeding. Congress intended the "reorganization in bankruptcy" distress test to be a test of last resort that would apply only in those cases of severe business hardship. As one court has observed, the purpose of the statute is to "limit to cases of severe business hardship the ability of plan sponsors to terminate their pension plans and thereby shift liability for guaranteed benefits onto other insurance premium payers in the PBGC programs."

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[4] PBGC reviews the notice of intent to terminate to determine whether it complies with ERISA's requirements. PBGC must notify the plan administrator of its determination in this regard. 29 C.F.R. §§ 4041.44(a) and (b). PBGC must also make a determination regarding the plan's sufficiency for guaranteed benefits or benefit liabilities. 29 U.S.C. § 1341(c)(3)(A); 29 C.F.R. § 4041.47.

US Airways, 296 B.R. at 743, *quoting Wire Rope*, 287 B.R. at 777.[5] Thus, in a distress termination, "[t]he appropriate standard of review . . . pursuant to [29 U.S.C.] Section 1341(c)(2)(B)(ii), is whether *but for* the termination of the pension plan, the [D]ebtor will not be able to pay its debts when due and will not be able to continue in business." *In re Resol Mfg. Co.*, 110 B.R. 858, 862 (Bankr. N.D. Ill. 1990) (emphasis added); *see also Wire Rope*, 287 B.R. at 777.

Congress first enacted the distress termination provisions as part of the Single-Employer Pension Plan Amendments Act of 1986 ("SEPPAA"), Pub. L. No. 99-272, 100 Stat. 237 (1986). SEPPAA did not set an explicit standard under the "reorganization in bankruptcy" test; it merely required the bankruptcy court to "approve[] the termination." Pub. L. 99-272, § 11009, 100 Stat. 237, 249-250. Congress adopted an explicit standard in 1987 when it enacted the Pension Protection Act ("PPA"), Pub. L. 100-203, 101 Stat. 1330-333. The PPA amendments specifically required a debtor in chapter 11 to show that it "will be unable to pay all of its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization." Pub. L. 100-203, 101 Stat. 1330-333. As explained by Rep. Schultz, a PPA conferee:

> The conference agreement narrowed the ability of a pension plan sponsor to transfer his pension plan obligations to the PBGC by the mere filing of a bankruptcy petition under chapter 11. Under the conference agreement a bankruptcy court judge will not allow a distress termination of a pension plan unless he determines that the company is unable to pay its debts pursuant to a plan of reorganization and continue in business outside of chapter 11.

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[5] The legislative history shows that "[t]he basic policy of the legislation is to limit the ability of plan sponsors to shift liability for guaranteed benefits onto other PBGC premium payers and to avoid responsibility for the payment of certain nonguaranteed benefits, to cases of severe business hardship." H.R. Rep. No. 300, 99th Cong., 1st Sess. 278, 279 (1985), *reprinted in* 1986 U.S.C.C.A.N. 929-930.

> Furthermore, a pension plan termination would be allowed *only if it otherwise would force the sponsor into liquidation*; and where, for example, the court had found that the sponsor had made meaningful sacrifices, such as in its pay package agreements.

133 Cong. Rec. H11970, Dec. 21, 1987 (emphasis added).

"The reference to 'a' plan of reorganization does not permit a distress termination simply because a particular plan requires it; rather the test is whether the debtor can obtain confirmation of *any* plan of reorganization without termination of the retirement plan." *US Airways*, 296 B.R. at 743-744; *Philip Servs.*, 310 B.R. at 808, *quoting US Airways*, 296 B.R. at 743-744; *Wire Rope*, 287 B.R. at 777; *In re Sewell Mfg. Co.*, 195 B.R. 180, 185 (Bankr. N.D. Ga. 1996). Importantly, ERISA requires that the distress test must be met by *each* debtor that is a plan sponsor or controlled group member and with respect to *each* pension plan sought to be terminated. *See, e.g.*, *Sewell*, 195 B.R. at 184.

Based on the statutory language under the "reorganization in bankruptcy" distress test, PBGC requests that this Court determine whether the Debtors have exhausted all other less drastic measures that would enable the Debtors to pay their debts under a plan of reorganization and continue in business outside Chapter 11. These measures can and should include evidence of the costs of maintaining the Debtors' Pension Plan, evidence on the costs of maintaining the Pension Plan if funding waivers are obtained or contributions are otherwise spread more evenly, evidence on the projected costs of the Pension Plan using different actuarial assumptions or methods, and evidence on whether there are other cost savings or discretionary spending in the debtors' business plan that can be used to fund the Pension Plan.[6] *See, e.g., US Airways*,

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[6] A defined benefit plan must be funded in accordance with the minimum funding standard prescribed by the I.R.C. and ERISA. I.R.C. § 412; 29 U.S.C. § 1082. The sponsor of a

296 B.R. at 744-46; *Philip Servs.*, 310 B.R. at 805, 808; *Wire Rope,* 287 B.R. at 777-80. Only after a fully developed record is made on these issues can the Court decide whether "but for" the termination of the Pension Plan, the Debtors would be forced to liquidate, and thereby make the necessary findings required by ERISA.

Often, a key question a bankruptcy court must resolve is whether the debtor will be able to obtain the necessary financing or equity infusions to emerge from bankruptcy if a pension plan is not terminated. *See, e.g., US Airways*, 296 B.R. at 745; *Philip Servs.*, 310 B.R. at 807; *Wire Rope,* 287 B.R. at 777; *Sewell,* 195 B.R. at 185. This question must be answered based upon the careful analysis of the available financial information taken as a whole, rather than relying on the potentially self-serving statements of any one proposed lender or investor. *See U.S. Airways*, 296 B.R. at 745-46. As Judge Wesley Steen of the United States Bankruptcy Court for the Southern District of Texas pointed out:

> The essence of the Debtor's argument in the instant case was that the pension plans must be terminated because the Investor said they must be terminated: *ipse dixit*. Accepting *that* argument would be tantamount to allowing the Investor to make the decision reserved to the bankruptcy court under ERISA. This court concludes that in determining whether a pension plan must be terminated as a distress termination, the bankruptcy judge should consider the provisions of a proposed chapter 11 plan (if one has been proposed at the time of the decision) but that the bankruptcy judge must also look to existential financial reality and try to judge whether the plan provisions are necessary or whether they are merely desired by the entities that would benefit from the termination.

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defined benefit pension plan may request from the Internal Revenue Service a waiver of the minimum funding contributions owed for a plan year if the employer is unable to satisfy the minimum funding standards for the plan year without temporary substantial business hardship. I.R.C. § 412(d); Revenue Procedure 2004-15, 2004-7 I.R.B. 490. The statute also requires the IRS to provide PBGC with the opportunity to comment on whether it believes the waiver should be granted. I.R.C. § 412(f)(3)(B). An employer may be required to provide security for any funding waiver, I.R.C. § 412(f)(3), and only three waivers can be obtained in any given 15-year period. I.R.C. § 412(d)(1).

Philip Servs., 310 B.R. at 808 (emphasis in original).

Thus, under the "reorganization in bankruptcy" test, the Debtors must support their assertions that they will be unable to obtain the necessary exit financing or equity infusions to reorganize and emerge from bankruptcy, with appropriate proof. Other courts, when analyzing similar assertions by debtors, all heard testimony regarding the debtors' efforts to obtain financing or equity infusions and their lenders' or investors' conditions precedent for providing needed capital. *U.S. Airways, Inc.*, 296 B.R. at 745-46; *Philip Servs.*, 310 B.R. at 805-06; *Wire Rope*, 287 B.R. at 775-76; *Sewell*, 195 B.R. at 185-86. Debtors should present similar evidence in this case.

Moreover, this Court should analyze the Debtors' evidence on the amount of cost reductions required to qualify for financing, to the extent the Debtors are capable of adducing such evidence. Information relevant to this inquiry might reasonably include the total amounts of: (1) projected costs other than pension funding in the business plan; (2) maximum expenditures permitted to qualify for financing; and (3) the difference between the total projected costs without plan termination over the maximum expenditures permitted to qualify for the financing. If this information cannot be provided in connection with the Pension Plan, it is uncertain whether the Debtors will meet the strict "reorganization in bankruptcy" standard.

Other areas on which the Debtors should be required to make showings satisfactory to the Court include:

- Whether the Debtors' funding projections are based on reasonable methods and assumptions.
- Whether consideration has been given to requesting a temporary funding waiver from the IRS based on a temporary business hardship.

- Whether the Debtors have independently considered other alternatives short of terminating the Pension Plan. For example, have the Debtors taken other cost-saving actions such as trimming capital expenditures, rejecting onerous contracts, reducing salaries, executive pay and/or non-essential expenditures, and head-count reductions?
- Whether the Debtors actively conducted the marketing process of Huffy to potential equity investors. For example, what were the assumptions in the offering memorandum presented to potential investors? Why were those assumptions chosen and are those assumptions correct? Did Huffy receive any competing equity bids for Huffy? Did the Debtors engage in any follow-up conversations or negotiations with any potential equity bidders? Were there any interested parties who were impeded from making a competing bid for Huffy? If so, what were the circumstances surrounding the impediment?

COMPLETION OF A DISTRESS TERMINATION

In this case, the Debtors seek to emerge from bankruptcy as a reorganized entity. The statute gives the bankruptcy court an important and clearly defined role – to determine whether the Debtors meet the "reorganization in bankruptcy" test, which requires this Court to carefully evaluate the Debtors' factual showing, and make findings whether, *but for* the termination of the Pension Plan, the Debtors will be forced into liquidation.[7] The import of this statutory standard is that creditors sometimes will have to accept lower recoveries in order to allow a pension plan to continue as long as *some* plan of reorganization is feasible without termination of the pension plan.

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[7] *See In re Amcast Indus. Corp.*, No. 04-40504 (Bankr. S.D. Ohio, June 2, 2005) (Order Determining that Debtors Satisfy the Financial Requirements for a Distress Termination of a Defined Benefit Pension Plan Pursuant to 29 U.S.C. § 1341(c)(2) and Approving Such Pension Plan's Termination) (copy attached as Exhibit 1).

Here, although the Court will determine whether the Pension Plan must be terminated in order to enable the Debtors to reorganize, it is important to note that the ultimate determination of whether the Pension Plan may be terminated in a distress termination rests with PBGC. *See Wire Rope*, 287 B.R. at 777. As one court explained:

> [T]he Court does not find itself faced with the ultimate question of the Debtor's entitlement to the termination of its pension plan. Instead, the Court simply must perform one narrow factual determination, the satisfaction of which will compose a single element in the Debtor's individual case for reorganizational "distress." The ultimate sufficiency of that distress showing, as well as the adequacy of the Debtor's required disclosures and the qualification of any "controlled group" parties, then will become a collective matter for the PBGC's consideration as it makes a final determination of the Debtor's right to a distressed termination.

Sewell, 195 B.R. at 185.

[INTENTIONALLY LEFT BLANK]

CONCLUSION

The Debtors must make the factual showings required by ERISA if this Court is to make the necessary determination that the strict criteria for distress termination of the Pension Plan is met. This Court may make this determination only if it is satisfied that the Debtors cannot generate enough cash flow to meet their obligations under any feasible plan of reorganization unless the Pension Plan is terminated.

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July 25, 2005

Respectfully submitted,

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